95-1701 ①

No.

Supreme Court, U.S.
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In The

Supreme Court of the United States

◆

October Term, 1995

MARTIN A. ARMSTRONG,

Petitioner,

vs.

COMMODITY FUTURES TRADING COMMISSION,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Does a regulation violate the First Amendment if it requires a publishing business to include within its advertisements warning language which is false with respect to the publications being advertised?

II. Where a statute expressly places the burden of proof of *scienter* upon a federal agency, may the agency shift that burden to the citizen if part of the citizen's mental state was based upon the uncontested advice of attorneys?

LIST OF PARTIES

The names of all parties to the proceedings in the court whose judgment is sought to be reviewed here appear in the caption of the case. There is no parent or subsidiary company of any party to be listed.

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OPINIONS BELOW

The opinion of the Court of Appeals is unreported and included in the Appendix and is reproduced in the Appendix filed herewith ("App.") at 1a. The opinions of the Commodity Futures Trading Commission ("CFTC") in this case are reproduced at 3a, 31a, 35a, 46a and 79a.

STATEMENT OF JURISDICTION

The Court of Appeals entered its judgment on January 19, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Commodity Futures Trading Commission ("CFTC") Regulation 4.41(b), 17 C.F.R. § 4.41(b)(1), provides:

> No person may present the performance of any simulated or hypothetical commodity interest account, transaction in a commodity interest or series of transactions in a commodity interest of a commodity pool operator, commodity trading advisor, or any principal thereof, unless such performance is accompanied by the following statement: "Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under-or-over compensated for the impact, if any, of certain market factors, such as lack of

> liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown."

Section 13(b) of the Commodity Exchange Act, 7 U.S.C. § 13c, provides:

> Any person who, directly or indirectly, controls any person who has violated any provision of this Act or any of the rules, regulations, or orders issued pursuant to this Act, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations, or orders may be held responsible for such violation as a principal. [As amended by Act of January 11, 1983 (Futures Trading Act of 1982), effective January 11, 1983, Sec. 230(1), 96 Stat. 2294, 2319.]

Section 4b of the Commodity Exchange Act provides:

> It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of any contract of sale of any commodity in interstate commerce, made, or

> to be made, on or subject to the rules of any contract market, for or on behalf of any other person, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, for or on behalf of any other person if such contract for future delivery is or may be used for (a) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (b) determining the price basis of any transaction in interstate commerce in such commodity, or (c) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof . . .

Section 4o of the Commodity Exchange Act provides:

> (1) It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly —
>
> (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or
>
> (B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

CFTC Regulation Section 4.41(a), 17 C.F.R. § 4.41(a) of the Commodity Futures Trading Commission's Regulations provides:

> Advertising by commodity pool operators, commodity trading advisors, and the principals thereof.
>
> (a) No commodity pool operator, commodity trading advisor, or any principal thereof, may advertise in a manner which:
>
> > (1) Employs any device, scheme or artifice to defraud any participant or client or prospective participant or client; or
> >
> > (2) Involves any transaction, practice or course of business which operates as a fraud or deceit upon any participant or client or any prospective participant or client.

CFTC Regulation Section 4.31, 17 C.F.R. § 4.31 provides:

> (a) No commodity trading advisor registered or required to be registered under the Act may solicit or enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the

> agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor seeks to direct the client's account or to guide the client's trading, in such form as the Commission may prescribe, containing the following information:
>
> (1)(i) The name, address of the main business office, main business telephone number and form of organization of the commodity trading advisor. If the address of the main business office is a post office box number, the trading advisor must state where its books and records will be kept;

STATEMENT OF CASE

A. Legal Proceedings Below.

In administrative adjudicatory proceedings conducted within the CFTC, the CFTC charged and found that four advertisements for a publishing business violated CFTC Regulation Section 4.41(b) because they failed to display the disclaimer language required by such Regulation. The CFTC found that Martin A. Armstrong ("Armstrong") was a control person of the publishing business within the meaning of Section 13(b) of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 13c. The CFTC found that Armstrong had "knowingly induced", within the meaning of Section 13(b), the violation of CFTC Regulation Section 4.41. (App. B, 29a).

The CFTC entered a cease and desist order and civil monetary penalty against Armstrong with respect to Section 4.41

and violations of other statutes and rules charged in four other counts of the administrative complaint.[1] The CFTC also entered a cease and desist order and civil monetary penalty against the publisher, Princeton Economic Consultants ("PEC"), which placed the ads. The Third Circuit Court of Appeals affirmed without opinion. (App. A, 1a).

B. The Underlying Conduct.

PEC published various journals and newsletters, including the Princeton Economic Quarterly, the Princeton Stock Futures Index Report, and the Princeton Gold Stock Report. Included among the publications which PEC offered the public, was a telephone call-in line. In this publication, PEC tape recorded each morning a commentary on market developments along with specific buy and sell recommendations. Subscribers could call the specified telephone number and listen to the pre-recorded message.

During the summer and fall of 1985, the buy and sell recommendations which PEC made daily on its newsline would, if followed, have resulted in phenomenal profits. PEC advertised this fact and basic descriptions of PEC's other publications in three advertisements placed in *Barron's* and one in *Investors Daily*.

The premise of these advertisements was that there is an intimate connection between a publisher's success in making real world predictions and the value to the public of the publisher's commentary on political events, prescriptions for economic ills, and analyses and predictions of market developments. Thus, the four advertisements first spoke of the correctness of PEC's market predictions on the call-in newsline.

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[1] Those violations were charged under the counts under Section 4*o* of the CEA, 4b of the CEA, and CFTC Regulations Sections 4.41(a) and 4.31.

The ads then spoke of and advertised subscriptions for various of PEC's other publications, *e.g.*, the Princeton Economic Quarterly.

The ads did not include the disclaimer set forth in CFTC Regulation Section 4.41(b), 17 C.F.R. § 4.41(b)(1). Such disclaimer would have cut the heart out of the advertisements' premise. It included, *inter alia*, the following disclaimer language:

> Hypothetical or simulated performance results have certain inherent limitations. . . . Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight.

Contrary to the disclaimer's above-quoted language, PEC's recommendations alleged to violate Section 4.41 were actual real-time market calls. They were not reconstructed with the "benefit of hindsight". They did not have such "inherent limitation". And they did represent correct predictions which, arguably, made PEC's publications worth considering to the American public.

Indeed, in late fall 1985, the National Futures Association ("NFA"), a statutorily qualified self-regulatory organization which aids the CFTC in the enforcement of the Commodity Exchange Act, sent auditors to PEC's offices in Princeton, New Jersey in order to audit the phenomenal success of the recommendations reported in the advertisements. Petitioner Armstrong spoke to the NFA auditor when she arrived at PEC's premises and quickly called PEC's attorney, Thomas Loughran, Esq.[2]

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[2] Attorney Loughran was the former head of the CFTC Division of Enforcement and an extremely experienced attorney with respect to commodity futures matters.

According to the NFA auditor's testimony, (a) Attorney Loughran demanded to speak to her and she took the receiver from Armstrong, and (b) Attorney Loughran then told her that the NFA and CFTC had no jurisdiction over PEC's advertisements because they were free speech ads for a free speech publishing business which was not required to register with the CFTC.[3] (App. H, 169a-173a).

However, Mr. Armstrong overruled PEC's attorney and let the NFA audit the recommendations. The NFA audit determined that each of the recommendations was made as and when stated, *i.e.*, the ads were actual, real-time market calls which predicted (without any "hindsight") what would occur in the market. Moreover, the NFA audit determined that an investor who followed the recommendations and purchased and sold at the prices recommended, would have received the profits set forth in the ads. In other words, the ads accurately depicted what would have happened if the recommendations had been followed and executed. (App. H, 169a-173a).

Because they did not include Section 4.41(b)'s above-specified disclaimer language, PEC's ads for such recommendations could and did correctly suggest to the public that PEC's real world successful recommendations indicated that PEC's publications were worth considering. However, the CFTC charged that the failure to include the disclaimer violated Section 4.41(b).

Vaguely acknowledging that the "hindsight" portions of the disclaimer were false as applied to PEC's ads, the CFTC nonetheless found that Armstrong had violated CFTC Regulation Section 4.41(b) by reasoning that Armstrong and

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[3] The correct premise of this advice was in *Lowe v. Securities and Exchange Commission*, 472 U.S. 181 (1985). In *Lowe*, this Court held that the SEC did not have jurisdiction over a publisher of newsletters concerning the securities markets.

PEC could have included in the advertisements only "those portions of the warning language that clearly applied". (App. B, 28a).

Without opinion and in conflict with other federal circuit courts as well as district courts within the Third Circuit, the Third Circuit Court of Appeals upheld the CFTC's decision. (App. A, 1a). Thereby, the Court effectively empowered the government to require a publisher to include in its advertisements for its publications false language which makes it more difficult for the publisher to obtain subscribers.

C. Second Question.

Further extending the chilling effect of its Regulation Section 4.41(b) upon freedom of the press, the CFTC charged and found that Armstrong was personally responsible, "as a control person" under Section 13(b) of the Commodity Exchange Act, for PEC's violation of Section 4.41(b) as well as for four other violations.[4] (App. B, 29a). Unlike the control person provisions in other statutory schemes,[5] the control person provision in the Commodity Exchange Act places upon the CFTC the burden of proof as to all control person issues. See statutory text of Section 13(b) quoted in full *supra*. Also unlike other statutory schemes, Section 13(b) of the CEA required the CFTC to prove a special requirement, *i.e.*, that the control person "knowingly induced" the acts constituting the violation. *Id*.

Armstrong contended that Attorney Loughran advised PEC that the CFTC had no jurisdiction over PEC's ads under *Lowe v.*

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[4] Those violations were charged under the counts under Sections 4*o* of the CEA, 4b of the CEA, and CFTC Regulation Sections 4.41(a) and 4.31.

[5] *E.g.*, Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o; Section 20 of the Securities Exchange Act of 1934, 15 U.S.C. § 78(t).

Securities and Exchange Commission, 472 U.S. 181 (1985). Indeed, as the NFA auditor herself testified, Attorney Loughran told the NFA and others that the NFA and CFTC had no jurisdiction. The testimony of Armstrong and the NFA auditor were uncontradicted at the hearing. They established that the reasonable advice under *Lowe, supra* was the advice that Attorney Loughran was, in fact, providing to Armstrong and PEC. (App. H, 169a-173a).

The CFTC responded to this argument by effectively shifting to Armstrong the burden of proof with respect to the "knowing inducement" portion of the control person test, as follows:

> Similarly, the record belies Armstrong's contentions about his reliance on counsel. In assessing the credibility of such claims, we look to a number of factors, including:
>
> > 1) a request for advice of counsel on the legality of a proposed action, 2) full disclosure of the relevant facts to counsel, 3) receipt of advice from counsel that the action to be taken will be legal, and 4) reliance in good faith on counsel's advice.

(App. B, 28a-29a). By affirming, the Third Circuit created a direct conflict with the decisions of other circuits and this Circuit which have determined that the issue of attorney reliance does not shift on to the citizen a statutorily imposed burden of proof with respect to *scienter*.

REASONS FOR GRANTING THE WRIT

This Court should grant the writ because the Third Circuit Court of Appeals has decided important federal questions in a way that conflicts with the relevant decisions of this Court. Further, this Court should grant the writ in order to resolve a split between the federal circuit courts of appeals on two important questions concerning the right of speech under the First Amendment and the rôle of reliance upon attorneys in establishing *scienter*.

Without a "definitive rule," or at least more specific guidance on both issues, the lower courts have created a hodgepodge of conflicting rules which have produced opposite results in similar cases.

I.

WHENEVER A GOVERNMENT-REQUIRED DISCLAIMER IS FALSE AS APPLIED TO THE ADVERTISEMENT IN QUESTION, THAT DISCLAIMER IS UNCONSTITUTIONAL.

The decision by the United States Court of Appeals for the Third Circuit strayed from this Court's prior holdings as well as precedent in other federal courts to issue a ruling that permits the government to burden commercial speech with false disclaimers. This result is unsupported by any principle of commercial speech jurisprudence, is contrary to the recent decisions[6] by this Court and other federal courts, and mistakenly precludes the Fourth Estate from advertising for their circulation without reciting government imposed falsities which cripple the publisher's ability to gain subscribers.

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[6] *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626 (1985); *Florida Bar v. Went For It, Inc.*, __ U.S. __, 115 S. Ct. 2371 at 2377 (1995), and *Edenfield v. Fane*, 507 U.S. 767 (1993).

In *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626 (1985), this Court upheld truthful disclaimer language against a First Amendment attack. The standards established by the Court should have made clear, however, that such a result would not apply to a false disclaimer. The Court reasoned as follows:

> [U]njustified or unduly burdensome disclosure requirements might offend the First Amendment by chilling protected commercial speech. But we hold that an advertiser's rights are adequately protected as long as disclosure requirements *are reasonably related* to the State's interest in preventing deception of consumers.

471 U.S. at 651 (Emphasis supplied). The Court took pains to add, however, that the disclaimer language must be "accurate":

> The right of a commercial speaker not to divulge *accurate* information regarding his services is not such a fundamental right.

Id. at n. 14 (Emphasis supplied).

By holding — in conflict with decision by this Court and other circuits — that commercial speech advertisements must display false statements required by the government, the Third Circuit clearly ignored this Court's foregoing teaching in *Zauderer*. Because of the importance of this federal question, certiorari should be granted.

The Third Circuit's decision also conflicts with the methodology used in this Court's other prior commercial speech decisions. The methodology of such decisions has developed into a three prong test which the government must satisfy in order to curb commercial speech:

> [F]irst, the government must assert a substantial interest in support of its regulation; second, the government must demonstrate that the restriction on commercial speech directly and materially advances that interest; and third, the regulation must be "narrowly drawn" , *id.*, at 564-565, 100 S. Ct., at 2350-51.

Florida Bar, 115 S. Ct. at 2376.

A. As Applied To Report's Advertisements, CFTC Reg. 4.41(b) Fails The "Real Harm" And "Material Alleviation" Prongs of This Court's Commercial Speech Test.

In contrast to the copiously detailed showing[7] of "real harm" and "material alleviation" in *Florida Bar*, 115 S. Ct. at 2377, here the CFTC made no showing of either. (App. B, *passim*). Nor could it: the result from a prediction which was actually made by a publication, does not and cannot involve any reconstruction "with the benefit of hindsight". Although the Administrative Law Judge recognized the need to make such findings and tried to do so (App. G, 159a-160a at ¶¶ 86-87), the CFTC vacated such findings, found them unreliable, and *failed* to make any findings of any governmental interests which might be furthered by this infringement upon freedom of the press and free speech.

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[7] In *Edenfield v. Fane*, 507 U.S. 761 (1993), this Court held:

> It is well established that "[t]he party seeking to uphold a restriction on commercial speech carries the burden of justifying it." [citations omitted] This burden is not satisfied by mere speculation or conjecture; rather, a governmental body seeking to sustain a restriction on commercial speech must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree [additional citations omitted].

Id. at 770-771, 113 S. Ct. at 1800. In almost nine years of proceedings, the CFTC failed even to try to show what harms would be alleviated by requiring false disclaimer language to be inserted into PEC's advertisements.

More generally, any regulation's disclaimer which is false as applied to the commercial speech at issue, will fail the "real harm" and "material alleviation" prongs of this Court's test. This is because a false disclaimer is misdirected and cannot alleviate anything. To avoid further confusion, this Court should grant this petition and clarify that disclaimers may not be applied to advertisements as to which they are false.

B. Numerous Less Burdensome Alternatives To Falsity Exist, Including Deletion Of The False Portion Of The Disclaimer With Respect To Actual, Real Time Recommendations.

In *Florida Bar*, this Court described the third prong of the commercial speech test as follows:

> "What our decisions require," instead, "is a 'fit' between the legislature's ends and the means chosen to accomplish those ends," a fit that is not necessarily perfect, but reasonable; that represents not necessarily the single best disposition but one whose scope is " 'in proportion to the interest served,' that employs not necessarily the least restrictive means but . . . a means narrowly tailored to achieve the desired objective." *Ibid.* (citations omitted).

Id., at 2380. In *Florida Bar*, as in most other commercial speech decisions, the challenged rule did not require the inclusion of false language in advertisements for publications.

However, in *Spencer v. Honorable Justices of Supreme Ct. of Pennsylvania*, 579 F. Supp. 880, 891-892 (E.D. Pa. 1984), the challenged rule did require a false or misleading disclaimer. Therefore, the Court struck down the rule. *Id.*, at 891-892, and *see* fn. 19 (listing alternative disclaimer which "would avoid any misleading implication"). Thus, even the lower federal courts within the Third Circuit itself, have effectively recognized that alternatives to false or misleading disclaimers will, inevitably, be available!

The acceptance by the Third Circuit of false disclaimer language is also in effective conflict with the decisions of other federal courts. The issue of whether to accept a false premise was presented in the advertisements at issue in *Abramson v. Gonzalez*, 949 F.2d 1567, 1576 (11th Cir. 1992). Such advertisements were placed by practicing psychologists holding themselves out as such in Florida but who had not received a psychology license from the State of Florida. Florida law permitted psychologists who had not received a license from the State of Florida to practice within her borders. *Id.* The false premise in *Abramson* was that made by the Florida law which prohibited psychologists from advertising themselves as such because of concerns about the competence of unlicensed psychologists. *Id.* at 1578. The Eleventh Circuit recognized the falsity of this premise and, therefore, rejected such restriction upon commercial speech. As long as the psychologists did not refer to themselves as "licensed psychologists", the Court held they could advertise. *Id.* at 1577; *accord Parker v. Commonwealth of Kentucky*, 818 F.2d 504, 509 (6th Cir. 1987) (dentists).

The Third Circuit's decision conflicts with the foregoing precedent of this Court and other federal courts. In effect, it would permit the government to hamstring publishers by requiring them to include false language within their advertisements. Similarly, it would permit the federal government to impose warning language in cigarette advertisements that "smoking is healthy" and less ridiculous but equally troubling falsities in the multitude of product advertisements by modern businesses. For all the foregoing reasons, this petition should be granted.

II.

The Third Circuit's affirmance of the CFTC's reasoning with respect to objective indicia of reliance upon attorneys, conflicts with the decisions of this Court and other circuits where a statute imposes on the government the burden of establishing *scienter*. Under those decisions, if the finder of fact determines that the citizen acted in good faith with respect to the conduct at issue, the government has failed to carry *its* burden of proving *scienter*. *United States v. Faust*, 850 F.2d 575, 583 (9th Cir. 1988) (Court's charge that government had burden of proving *scienter* "adequately conveyed" that if the defendant acted in good faith then the jury could not convict); *accord United States v. Anderson*, 872 F.2d 1508 (11th Cir. 1989), *cert. denied sub nom Anderson v. United States*, 493 U.S. 1004 (1989).

Indeed, in *Cheek v. United States*, 498 U.S. 192 (1991), this Court held as follows:

> But *carrying this burden requires negating a defendant's claim of ignorance of the law or a claim that because of a misunderstanding of the law, he had a good-faith belief that he was not violating any of the provisions of the*

> *tax laws.* In the end, *the issue is whether, based on all the evidence, the Government has proved that the defendant was aware of the duty at issue, which cannot be true if the jury credits a good-faith misunderstanding and belief submission,* whether or not the claimed belief or misunderstanding is objectively reasonable.

498 U.S. at 203 (Emphasis supplied). Nor is this a case in which, as in *Cheek*, the presentation of conflicting evidence regarding reliance upon an attorney could erroneously be thought to trigger the necessity of satisfying various objective elements of proof. *Compare Cheek, supra,* in which the attorneys had testified in a manner that was directly contrary to the defendant with respect to the alleged legal advice. *United States v. Cheek*, 3 F.3d 1057 at 1061-1062 (7th Cir. 1993), *rev'd,* 498 U.S. 192 (1991).

Rather, all the evidence — including the testimony of the NFA auditor — in this case established that an experienced attorney was asserting to Armstrong, as well as to the NFA and the CFTC, that the CFTC and NFA did not have jurisdiction over PEC's advertisements. (App. H, 169a-173a). *See Lowe v. Securities and Exchange Commission,* 472 U.S. 181 (1985). Similarly, the entire body of evidence with respect to the other counts showed not only that the attorney prepared the allegedly violative disclosure documents but was fully informed of the relevant facts by both Mr. Armstrong and, again, another witness (Mr. Bruce Winans). (App. I, 174a-177a).

Therefore, the issue for the CFTC to decide was whether, under the uncontested evidence of attorneys' advice, the CFTC had carried its burden of establishing that Armstrong "knowingly induced" PEC to violate CFTC Regulation Section 4.41(b). The same issue was presented with respect to the allegedly fraudulent conduct charged in three other counts[8] and the non-fraudulent conduct charged in the fifth and final count.[9] In conflict with the holdings of other circuits and of this Court, the CFTC failed to consider (and failed to express any consideration of) attorneys' advice with respect to its findings under three counts: the counts under Section 4b of the CEA, Section 4*o* of the CEA, and CFTC Regulation Section 4.31. (App. B, *passim*).

The CFTC did purport to consider the attorneys advice issue with respect to the two counts involving PEC's advertisements, CFTC Regulation Sections 4.41(a) and 4.41(b). However, in explicit conflict with other circuits[10] and this Court's holding in *Cheek*, the CFTC imposed upon Armstrong various artificial evidentiary hurdles which, it effectively held, a citizen supposedly must satisfy any time the citizen's uncontested reliance upon attorneys negates *scienter*. (App. B, 28a-29a).

The Third Circuit affirmed. Thereby, it erroneously permitted the CFTC to disregard the uncontested evidence relevant to (and negating) *scienter*, in conflict with other circuits and this Court's holding in *Cheek*. *See Cheek*, 498 U.S. at 206-207 (error to instruct jury to disregard evidence of citizen's understandings where government must prove "willful" conduct). In conflict with other Circuits and this Court's decision in *Cheek*, the Third Circuit also permitted the CFTC to erect artificial evidentiary hurdles with respect to attorneys advice, which effectively shifted on to Armstrong the burden of proving he did not "knowingly induce" the violations at issue.

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[8] The counts under Section 4*o* of the CEA, 4b of the CEA, and CFTC Regulations Section 4.41(a).

[9] The count under Section 4.31 of the CFTC's regulations.

[10] *United States v. Faust*, 850 F.2d 575, 583 (9th Cir. 1988); *United States v. Anderson*, 872 F.2d 1508 (11th Cir. 1989).

This conflict involves facts of a recurring nature. Businesses rely upon attorneys' advice every day, particularly where complex federal regulations may be at issue. Precisely due to this complexity, Congress frequently imposes a burden upon the government to prove *scienter* in order to establish a violation. *Cheek,* at 199-200. The Third Circuit decision will decisively defeat this Congressional design (and, thereby, sever the law's connection with the realities of modern business in a complex regulatory environment). For all the foregoing reasons, this Court should grant this petition and provide necessary guidance on this important and frequently recurring federal question.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A — JUDGMENT ORDER DATED JANUARY 19, 1996

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 95-3161

MARTIN A. ARMSTRONG,
Petitioner

v.

COMMODITY FUTURES TRADING COMMISSION,
Respondent

On Petition for Review of an Order of the
Commodity Futures Trading Commission
(CFTC Docket No. 87-10)

Argued January 10, 1996

Before: SCIRICA, ALITO and WEIS, *Circuit Judges*

JUDGMENT ORDER

After consideration of all contentions raised by the parties, it is

ADJUDGED AND ORDERED that the petition for review is hereby DENIED and the order of the Commodity Futures Trading Commission is AFFIRMED.[1]

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[1] We have jurisdiction over the appeal. *See Bordallo v. Reyes*, 763 F.2d 1098 (9th Cir. 1985).

Costs taxed in favor of the Commission.

BY THE COURT,

s/ illegible
Circuit Judge

Attest:

s/ P. Douglas Sisk
P. Douglas Sisk, Clerk

JAN 19 1996

APPENDIX B — OPINION AND ORDER DATED MARCH 10, 1995

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

CFTC Docket No. 87-10

In the Matter of
MARTIN A. ARMSTRONG

OPINION AND ORDER

Respondent Martin A. Armstrong appeals from an Administrative Law Judge's ("ALJ") decision holding him liable as a controlling person for the violative conduct of two corporate entities.[1] He raises both procedural and substantive challenges to the ALJ's analysis. He requests dismissal of all the Division of Enforcement's ("Division") allegations or, in the alternative, a remand for further development of the evidentiary record. The Division opposes these requests and urges us to affirm the result of the ALJ's analysis.

As explained more fully below, we conclude that deference to the ALJ's factual assessments is not justified on the record before us. Nevertheless, based upon our independent review of the factual record, we concur with the ALJ's conclusion that the weight of the evidence demonstrates Armstrong's liability as a controlling person for the violations of the Act and Commission regulations committed by the corporations he controlled.

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[1] This is our second decision on the merits of this appeal. In our first decision, we summarily affirmed the material portions of the ALJ's initial decision. *In re Armstrong*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,657 (CFTC Feb. 8, 1993). The United States Court of Appeals for the Third Circuit subsequently vacated and remanded for additional proceedings. *Armstrong v. CFTC*, 12 F.3d 401 (3d Cir. 1993). On remand, we gave both parties an opportunity to rebrief the issues material to respondent Armstrong's liability as a controlling person under Section 13(b) of the Commodity Exchange Act ("Act").

BACKGROUND[2]

I.

During the 1970s, respondent Martin Armstrong began to publish market predictions and recommendations about commodity prices in the physical and futures markets, particularly market price trends for precious metals. Tr. 1020-1040. At that time, Armstrong engaged in these activities as a "hobby." Tr. 1042. When he first started making market predictions and recommendations using a teletype system, he did not charge for his recommendations. Tr. 1031-1035. In early 1983, Armstrong decided to form three new corporations, Princeton Economic Consultants ("PEC"), Economic Consultants of Princeton, Inc. ("ECP") and Armstrong Report, Inc. ("Report, Inc.") so that he could accept paid subscriptions from members of the public for his newsletters and publications which provided advice on trading in the commodity futures markets. Tr. 1045-1046. Armstrong became the principal, sole stockholder, president and director of PEC. He also became the president and director of ECP and Report, Inc. Tr. 1766-69. Armstrong operated all three corporations out of the same office in Princeton, N.J. Tr. 872, 1773, 1784 .[3]

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[2] As explained below, these findings reflect our *de novo* review of the record in this matter. While they are generally consistent with the findings reflected in the initial decision, we have not relied upon the ALJ's factual assessments in resolving this matter.

[3] PEC was a holding company and the principal and sole owner of ECP (Cont'd)

Appendix B

ECP, through Armstrong, was responsible for managing client accounts and providing personal consultation service commencing in August 1983. Tr. 49, Div. Ex. 105, 107. From September 1983 through July 1985, clients of ECP opened future trading accounts at Rudolf Wolff Commodity Brokers, Inc. ("Rudolf Wolff"), a futures commission merchant. Armstrong himself placed numerous trades for commodity futures contracts on precious metals for ECP's managed accounts through Rudolf Wolff. Tr. 628, Tr. 446, Div. Ex. 107. During the summer of 1983, Armstrong held a series of meetings with Leo Wetter, an account executive for Rudolf Wolff, and Bruce Winans, a college roommate of Mr. Wetter and the brother of a friend of Armstrong. Tr. 617-620. At these meetings, Armstrong discussed trading his managed accounts through Rudolf Wolff and engaging in a commission sharing arrangement with Rudolf Wolff. Tr. 617-618.

An initial unsigned draft of an agreement between Rudolf

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and Report, Inc. PEC was never registered with the Commision in any capacity. Through this firm, Armstrong provided personal consultation and seminar programs about trading in the futures markets to the general public. PEC has ceased doing business.

ECP, which was incorporated on May 27, 1983, was a subsidiary of PEC. It managed clients' investments. ECP was registered with the Commission as a CTA from July 2, 1985 through July 31, 1986. It has ceased doing business and is not currently registered in any capacity.

Report, Inc. was another subsidiary of PEC. Armstrong established it to issue written reports to clients and to disseminate telephone and telex newsline messages to clients. Report, Inc. was registered as a CTA from July 2, 1985 through July 31, 1986. Report, Inc. has also ceased doing business and is not currently registered in any capacity.

Wolff and ECP was dated September 1, 1983. Div. Ex. 54. One provision in that unsigned agreement specified that Rudolf Wolff would rebate to ECP up to 25 percent of the commissions received from Armstrong's managed account clients if those commissions exceeded $200,000. The agreement further provided that Rudolf Wolff would charge ECP's managed account clients $50 per trade. There were additional meetings after trading commenced in September 1983. Tr. 659. Then, on October 21, 1983, Rudolf Wolff sent a letter to Armstrong signed by Bruce Cleland, President of Rudolf Wolff, and Leo Wetter which outlined the agreement Armstrong had reached with Rudolf Wolff, including the commission sharing agreement. Div. Ex. 55. After six months, it became apparent that the commissions generated from Armstrong's managed accounts would not reach the $200,000 threshold specified in the agreement. On April 18, 1984, Cleland and Wetter again wrote to Armstrong confirming their agreement, among other things, to suspend the commission rebate agreement discussed in the October 21, 1983 letter. Div. Ex. 56. In September 1984, ECP filed a disclosure document dated August 15, 1984 with the CFTC and distributed it to its managed account clients.[4] This disclosure document specifically stated that ECP "does not receive any percentage of commissions paid by the client to any futures commission merchant. Div. Ex. 15 at 7. It also specified that any questions concerning this Company or its program of account management should be directed to the Company's President, Mr. Martin A. Armstrong. . . ." *Id.* at 9.

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[4] Regulation 4.31(a) requires a CTA registered or required to be registered under the Act to deliver a "Disclosure Document" to a prospective client before or at the time the CTA solicits or enters into an agreement with such a prospective client to guide the client's commodity interest trading. Regulation 4.31 specifies the information required to be contained in the disclosure document to include any actual or potential conflict of interest, especially:

> [A]ny arrangement whereby the trading advisor or any principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with a futures commission merchant. . . .

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Shortly after the dissemination of the September 1984 Disclosure Document, ECP, through Armstrong, and Rudolf Wolff negotiated and entered into another commission sharing agreement. Tr. 653-661, 685, 905-909, 966. The rebate payments were based on the number of contracts traded and the amount of commissions paid by the managed account clients on a per trade basis according to a negotiated scale. Div. Ex. 127, Tr. 653-663.

Rudolf Wolff made the first payment of commission rebates to ECP in December 1984. Div. Ex. 125. Several months later, Armstrong again met with Wetter and Cleland and adjusted the payments to ECP to reflect current business levels. Div. Ex. 127. From December 1984 until December 1986, ECP received more than $83,000 in commission rebates. Div. Ex. 125, Tr. 666, 792-98, 802-04.

Over one and a half years after the first rebate payment, ECP filed another disclosure document with the Commission. Div. Ex. 16. The 1986 Disclosure Document stated that ECP had "from time to time" entered into a commission rebate arrangement with another firm. *Id.* Between October 1984 and the time when the 1986 Disclosure Document was distributed,

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If any of the information in the disclosure document becomes materially inaccurate or incomplete, Regulations 4.31(b)(1) and 4.31(f)(2) further require the CTA to correct the defect and distribute the corrections to its clients within 21 days.

ECP's managed account clients were not informed of the commission rebate arrangement. Tr. 260-61, 470-71, 3094. Instead, Armstrong instructed Mark Lively, an ECP employee and managed account client, not to "mention any other brokerage house. . ." when dealing with clients, and also advised Lively "to recommend [the clients] use of Rudolf Wolff-New York, specifically Leo Wetter, because we get a piece of the action; we get kick backs from every trade they do." Tr. 469-472.

During the same time period, Armstrong prepared various advertisements for PEC which were placed in various financial publications. PEC placed the first advertisement in Barron's on October 14, 1985. The headline on this advertisement announced that "We Made $5,000 per Contract in September Alone!" Additionally, the text of the advertisement claimed: "In September 1985, our specific trading recommendation on the S&P futures showed a $5,275 profit on 17 trades-per contract." Div. Ex. 79. The advertisement also contained a bar chart with various market entry and exit points indicated which is labeled as "Sept. S&P Futures Daily Track Record."

Another advertisement was placed in Barron's on November 25, 1985 and repeated on December 9, 1985. Div. Ex. 80-A. That advertisement, with the headline "We Made $11,150 Per Contract," also stated in its text:

> In October we ran an ad in *Barron's* just after covering all our short positions into the September low. We made $5,275 per contract in September alone . . . Well, while everyone was selling the market short in November we were aggressive buyers, and in the past three months we have made $11,500 per contract on the S&P Futures.

Div. Ex. 80-A. This advertisement also contained a bar chart with various entry and exits points indicated, and labeled as "S&P Futures Daily Track Record." *Id.*

Finally, Armstrong also prepared and arranged to place another advertisement in *Investor's Daily* on January 6, 1986. In the text of this advertisement, respondent compares itself favorably with other active traders such as investment portfolio managers. The advertisement also asserts it has "been consistently on the right side of this market . . ." Similarly, PEC represents in this advertisement that:

> Our performance in the S&P Futures has been spectacular. Between September 1 and November 22, we produced $13,125.00 per contract traded at each specific recommendation on 48 trades. We sold the market right into the September low and turned around and bought it right up to the highs. The results were audited by the National Futures Association.

Div. Ex. 111, Complaint II, Exhibit C.

II.

On September 30, 1985, the Commission issued a complaint against Armstrong and the three corporations. This complaint, CFTC Docket No. 85-47, charged the four respondents with conducting a CTA business without being registered and with related violations. A second complaint ("Second Complaint") was issued against Armstrong, PEC and ECP by the Commission on June 23, 1987 in CFTC Docket No. 87-10. This complaint alleged that: (1) ECP violated Sections 4b(A) and 4*o*(1) of the Act and Regulation 4.31(b) by failing to disclose to managed-account clients the existence of a commission rebate agreement with a futures commission merchant in a timely manner (Counts One through Three); (2) PEC violated Regulation 4.41(a) and (b) by publishing advertisements which misrepresented hypothetical performance results as actual trading and by omitting a required disclaimer (Counts Four and Five); and (3) Armstrong was liable as a controlling person under Section 13(b) for knowingly inducing ECP's and PEC's violations (Counts One through Five).

Both complaints were consolidated for hearing. On October 30, 1989, the ALJ issued an initial decision ("I.D.") finding Armstrong and the three corporations liable for all violations charged in both complaints. In re Armtrong, 1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,545 at 36,365 (I.D. Oct. 30, 1989). At the outset, the ALJ concluded that Armstrong and the three corporations had acted as a "single enterprise." For this reason, in assessing the evidence relevant to the two complaints, the ALJ rarely distinguished between Armstrong's conduct and the conduct of the various corporate respondents. Consistent with this approach, in concluding that Armstrong was liable for the wrongdoing alleged in the Second Complaint, the ALJ did not specifically address the complaint's basis for holding Armstrong personally liable—his role as a controlling person of the corporate respondents and his inducement of their violative conduct. The judge, however, did make several findings about Armstrong's role in managing the corporate respondents.[5]

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[5] The ALJ found that Armstrong "had and exercised full domination and control over the three corporate Respondents." ¶ 24,545 at 36,344. Specifically, the ALJ found that Armstrong was the founder, sole shareholder, president, sole

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Appendix B

In reviewing the Second Complaint's allegations concerning ECP's failure to disclose its commission sharing arrangement, the judge found that when ECP and Rudolf Wolff entered into the commission sharing agreement in October 1984 (with payments to commence in December 1984), the respondents were on notice that the August 1984 disclosure document was materially inaccurate. The ALJ found that, despite this notice, neither Armstrong nor ECP informed managed-account clients of the rebate agreement until the distribution of the 1986 Disclosure Document. On this basis, the ALJ concluded that ECP and Armtrong had violated Sections 4*o* and 4b of the Act by willfully failing to reveal the existence of the commission sharing agrement. ¶ 24,545 at 36,358. Additionally, the ALJ held that Armstrong and ECP violated Commission Regulation 4.31(b)(1)(i) by willfully failing to correct the defect in the 1984 Disclosure Document and distribute the correction within 21 days of October 31, 1984.

Turning to the allegations about PEC's advertising, the ALJ concluded that PEC and Armstrong violated Commission Regulation 4.41(a) by willfully employing false and misleading advertising. According to the ALJ, Armstrong and PEC represented in the advertisements that the monetary results claimed were derived from actual trades which they had placed in the futures market. ¶ 24,245 at 36,361. The ALJ concluded that these representations were deceptive because PEC or Armstrong

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director and only officer of the corporations; hired and trained employees for the corporations; wrote the reports issued by the corporations; gave personal consultations; prepared the market analyses; conducted the seminars; prepared the advertisements; made trading decisions in the client managed accounts; regarded the corporate repondents' files as his own; and ran all the companies. ¶ 24,545 at 36,342, 36,344.

did not place any actual trades. *Id.* Similarly, the ALJ found that PEC's reference in an advertisement to a National Futures Association ("NFA") audit was false and misleading because there had been no trades to audit. *Id.* Finally, the ALJ concluded that ECP and Armstrong violated Commission Regulation 4.41(b)(1) when they failed to include a required disclaimer concerning the use of hypothetical trading results in the promotional materials. ¶ 24,545 at 36,360, 36,362.

The ALJ sanctioned the respondents by entering cease and desist orders and 12-month trading bans against them and by revoking their registrations. *In re Armstrong,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,609 (Feb. 28, 1990) ("Initial Decision as to Sanctions"). He also assessed civil money penalties against the respondents, including a civil money penalty of $24,000 against Armtrong.

III.

The respondents appealed to the Commission which issued an opinion on February 8, 1993 affirming in part and reversing in part. Initially, the Commission determined that the ALJ had reached a "substantially correct result" in analyzing the allegations raised in the Second Complaint. Because, in its view, the challenges respondents raised to this aspect of the ALJ's decision did not merit a detailed discussion, the Commission summarily affirmed these liability findings without opinion.

The Commission however, found merit in some of respondents' challenges to the ALJ's analysis of the First Complaint. Initially, it concluded that the ALJ erred by undertaking a unitary approach to liability and found that neither the language nor structure of the First Complaint suggested that a unitary approach to liability had been the Commission's intent. In light of this conclusion, the Commission declined to defer generally to the ALJ's factual assessments and specifically acknowledged that *de novo* factfinding would be necessary when the judge's findings were "colored by his improper unitary approach." *In re Armstrong*, 25,657 at pp. 40,145. Based upon its independent review of the record, the Commission affirmed the ALJs liability findings as to the three corporate respondents, with modifications. It found, however, that the record did not support a finding that Armstrong was individually liable for failing to register as a CTA.

Given its vacation of the ALJ's liability findings against Armstrong in CFTC Docket No. 85-47, the Commission reduced Armstrong's civil money penalty from $24,000 to $12,000. In addition, it vacated the trading bans and registration revocations the ALJ had imposed on respondents.

IV.

All four respondents petitioned for review of the Commission's decision to the United States Court of Appeals for the Third Circuit. After the corporate respondents' petition were dismissed[6] respondent Armstrong focused his appeal on the Commission's summary affirmance of the initial decision's analysis of the Second Complaint. In vacating that aspect of the Commission's decision, the court emphasized the Commission's rejection of the ALJ's unitary approach to respondents' liability under the First Complaint. In the court's view, the Commission's refusal to endorse the ALJ's unitary approach "broke a critical link in the chain of reasoning" supporting the ALJ's analysis of Armstrong's liability under the Second Complaint. *Armstrong*, 12 F.3d at 405. Given the brevity of the Commission's analysis, the court explained, it could not determine how the Commission concluded that the defect in the ALJ's-unitary approach had not undermined the reliability of his analysis of the allegations raised in the Second Complaint. On this basis, the court vacated the summary affirmance portion of the Commission's decision in CFTC Docket No. 87-10 for failure to comply with Section 557(c) of the Administrative Procedure Act ("APA").[7] It remanded CFTC Docket No. 87-10 to the Commission for further proceedings. *See Armstrong v. CFTC*, 12 F.3d at 401 (3d Cir. 1993).[8]

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[6] The Third Circuit found that it lacked jurisdiction over the corporations' appeals because they had ceased doing business within the circuit. The court further provided that the case would continue only as to Armstrong in his individual capacity. As the liability findings and sanctions against Armstrong emanated only from CFTC Docket No. 87-10, that proceeding alone remained before the court.

V.

In response to the court's order of remand, the Commission gave both respondent Armstrong and the Division an opportunity to submit a brief addressing whether the existing record supports the conclusion that Armstrong (1) controlled the corporate respondents named in the Second Complaint; and (2) did not act in good faith, or knowingly induced, the wrongful conduct of the corporate respondents within the meaning of Section 13(b) of the Act. *In re Armstrong*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,031 (CFTC Mar. 25, 1994). Both parties responded with briefs discussing these and related issues. In addition, Armstrong submitted a motion to dismiss or, in the alternatives, to reopen the record. The Division filed in opposition to both requests for relief.

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[7] Section 557(c) of the APA requires agencies to provide "an adequate statement of . . . findings and conclusions, and the reasons or basis therefore, on all the material issues of fact, law or discretion presented on the record." 5 U.S.C. § 557(c)(1988).

[8] In its opinion, the court indicated that, on remand, the Commission could pursue any appropriate method of proceeding, including: (1) adopting findings of fact or reasoning of the ALJ that were not colored by the unitary approach; (2) conducting *de novo* factfinding; or (3) remanding to the ALJ.

DISCUSSION

A. *Preliminary Matters*

In support of his motion to dismiss or, in the alternative, to reopen the record, Armstrong argues that the Commission should dismiss the Second Complaint because it failed to conduct this proceeding in a manner consistent with Section 555(b) of the APA.[9] Armstrong argues, in effect, that the pace of this proceeding has been both too fast and too low. First, he argues that the ALJ was hasty in scheduling the hearing in this matter. He asserts that by requiring Armstrong to go to trial immediately after the deadline for answering the Second Complaint, the judge deprived him of an adequate opportunity to conduct discovery. Second, he emphasizes that this proceeding has been pending for more than seven years but remains unresolved.

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[9] Section 555(b) of the APA, 5 U.S.C. § 555(b), provides:

> . . . With due regard for the convenience and necessity of the parties or their representatives and within a reasonable time, each agency shall proceed to conclude a matter presented to it. . . .

Alternatively, Armstrong seeks relief that would further delay the ultimate resolution of this matter, arguing that the Commission should reopen the "cold record" to develop evidence on factual issues material to controlling person liability, including: (1) Armstrong's role in drafting ECP's disclosure documents; and (2) Armstrong's and PEC's reliance upon the advice of legal counsel about the advertising they employed.

The Division opposes these motions on the basis that Armstrong waived any objection to the timing of discovery and the hearing in this matter by failing to raise these issues in his initial appeal to the Commission.[10] It argues that Armstrong also played a role in delaying the resolution of this matter and that there is no evidence that Armstrong has been prejudiced by the passage of time since this proceeding was commenced. Finally, the Division opposes Armstrong's request to reopen the record noting that Armstrong had a full and fair opportunity to address factual issues relevant to his liability at the hearing, and has failed to demonstrate the type of circumstances that would justify admission of new evidence pursuant to Commission Rule 10.107.

We find no support in the record for Armstrong's motion to dismiss. The bulk of the delay in resolving this proceeding took place prior to Armstrong's appeal of this matter to the United

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[10] The Division also objects to Armstrong's description of the facts underlying this aspect of his challenge. It contends that Armstrong was provided with discovery materials pursuant to Commission Rule 10.42 prior to the hearing in this matter. It also notes that while the ALJ denied Armstrong's motion to postpone the hearing, he took steps to assure that Armstrong and his counsel had ample time to present his defense to the allegations in the Second Complaint.

States Court of Appeals for the Third Circuit. Armstrong, however, did not raise the issue of delay before the court. In raising the issue on remand, respondent ignores both his own role in prolonging this proceeding and the absence of evidence that he has been prejudiced by the passage of time.[11] In these circumstances, there is no basis for finding that the delay in resolving this matter amounts to a violation of the requirements of the APA.

The remaining arguments respondent raises in his motion merit only brief attention. First, Armstrong's objections to the timing of discovery and the hearing are simply too late. Nothing in the Third Circuit's opinion suggests that its remand was intended to provide Armstrong with an opportunity to litigate issues he had previously chosen to bypass. Armstrong failed to raise these procedural challenges before either the Commission or the court, and offers no explanation for his changed position. In these circumstances, we find that Armstrong has waived his objection.

Armstrong's request to reopen the record is similarly flawed. Prior to the court's remand, Armstrong had notice of all the charges against him and a full and fair opportunity to litigate the facts at issue. Armstrong has made no effort to address the standards for reopening the record under Commission Rule 10.107. In the circumstances, the motion is denied.

In his brief, Armstrong objects to our order establishing a common deadline for the parties' submission of briefs on remand. He argues that because the Division has the burden of proving the allegations in its complaint, it should have been required to make the initial filing, or he should have been given an opportunity to file a response to the Division's submission. Respondent cites no precedent in support of his curious claim that the party with the burden of proof is obliged to make the initial submission of arguments on appeal. The Commission's Rules of Practice follow the usual appellate practice of requiring the appealing party to make the initial submission of arguments on appeal. Since Armstrong, not the Division, is the appealing party in this matter, he has no basis for claiming that he has been prejudiced by our selection of a common deadline for submitting briefs on remand.[12]

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[11] In determining the reasonableness of time for agency action, courts have balanced the interests affected by a delay and considered the prejudice caused. *See NLRB v. J.H. Rutter-Rex Mfg. Co.*, 396 U.S. 258, 265-6 (1969) ("deplorable" delay of nine years did not justify interference with the NLRB's remedial power). In his motion, Armstrong made no claim of prejudice.

B. *Reliance on the ALJ's Initial Decision*

As noted above, when it remanded this matter to the Commission, the Third Circuit indicated that the Commission could adopt any of the ALJ's findings of fact that were not colored by the unitary approach we rejected in our first decision in this case. Under our precedent, however, when clear error has been committed, we have a duty to intervene and undertake appropriate corrective action. *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH)

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[12] In his brief, Armstrong seeks a Commission ruling on his motion to expand the record to admit new evidence, a May 1990 affidavit of Bruce Babcock, which purports to explain the trade usage meaning of the term "track record." Armstrong tendered this affidavit more than two years after the liability hearing and five months after declining to participate in the sanctions hearing. We deny this motion because Armstrong has not made a sufficient showing under Rule 10.107 of the Commission's Rule of Practice to justify admission of this new evidence two years after the close of the liability hearing.

¶ 25,266 at 38,848 (CFTC Apr. 1, 1992). The court's holding that the ALJ's unitary approach amounted to a "critical link" in his analysis of the allegations of the Second Complaint raises sufficient questions about the soundness of the ALJ's factual assessments to warrant *de novo* review by the Commission. We begin with a review of the evidence establishing the corporate respondents' liability for the underlying violations.

C. *ECP's and PEC's Liability*

Under Sections 4b and 4*o* of the Act, ECP had a duty to disclose material facts, such as the existence of a commission sharing arrangement, to its clients. A knowing breach of this duty constitutes fraud. *In re Stotler and Co.,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,298 at 32,814 (CFTC Sept. 30, 1986), *aff'd Stotler and Co. v. CFTC,* 856 F.2d 1288 (7th Cir. 1988); *In re Citadel Trading Co. of Chicago. Ltd.,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,082 at 32,185-88 (CFTC May 12, 1986).

Regulation 4.31(a)(5)(i) imposed an independent duty on ECP to provide a disclosure document to prospective clients, and specifically mandates that this document describe "any actual or potential conflict of interest," including "any arrangement whereby the trading advisor [ECP] or any principal thereof [Armstrong] may benefit, directly or indirectly, from the maintenance of" a client's account with a FCM. To assure the continuing accuracy of this disclosure, Section 4.31(b) required ECP to correct any material inaccuracy in the document, and distribute the revised document to existing managed account clients, within 21 days of the date it discovered (or should have discovered) the inaccuracy.

The record demonstrates that ECP distributed a disclosure document to its clients from September 25, 1984 to mid-1986 which represented that ECP [did] not receive any percentage of commissions paid by the client to any futures commission merchant." Div. Ex. 15 at 7. Prior to the distribution of this disclosure statement, however, Rudolf Wolff and ECP had agreed to share any commissions generated by accounts managed by ECP which exceeded a $200,000 threshold. Because the threshold was never reached, ECP did not directly benefit from this arrangement. After the 1984 Disclosure Document was distributed, however, ECP and Rudolf Wolff negotiated an adjustment to the terms of their commission sharing arrangement. In December 1984, Rudolf Wolff made actual payments to ECP in accordance with the revised agreement.

ECP did not correct its disclosure document to disclose this arrangement within the 21 days specified in Regulation 4.31(b)(1)(i). Indeed, the record shows that ECPs managed account clients were not informed of the commission sharing arrangement until a second disclosure document, dated June 1, 1986, was distributed. Tr. 260, 470-471.

Once payments were received under the revised agreement, there was an actual conflict which ECP was obliged to disclose to it managed account clients.[13] Moreover, the testimonial evidence establishes that ECP's managed account clients were not timely informed of the existence of the commission sharing arrangement, and, in fact, that this information was deliberately withheld from them. Tr. 469-72. In these circumstances, ECP's failure to make the required disclosure until June 1986 constituted willful fraud in violation of Sections 4(b)(A) and 4*o*(l) of the Act and Regulations 4.31(a) and (b).

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[13] We also note that ECP's initial agreement with Rudolf Wolff created a potential conflict of interest which ECP was obliged to disclose to its customers.

Regulation 4.41(a) prohibited PEC from advertising in a manner which involves any transaction, practice or course of business which operates as a fraud or deceit upon either a client or prospective client. The record establishes that PEC placed a series of advertisements in financial publications, which, taken as a whole, created an impression that, during a specified period of time, PEC or an affiliated company had achieved a remarkable success rate trading S&P500 stock index futures contracts. This impression was fostered by the use of such terms as "we made," "bought it," "we sold at the market," "we were aggressive buyers," and "total profits."

The record also establishes that PEC did not actually place any of the orders, execute any of th trades or make any of the profits touted in the advertisements. In each advertisement, the claimed performance results, as well as the graph of PEC's purported "track record" were based solely on recommendations offered to telephone newline subscribers. In effect, the advertisements described what PEC believed "would have happened" if a customer had traded in accordance with its recommendations. In one advertisement, PEC suggested that its trading results had been "audited" by NFA, thereby creating an impression that the results of its trading had been independently verified.

In his brief on remand, Armstrong emphasizes that an examination by NFA determined that the results described in PEC's advertisements accurately reflected what would have happened if a client had successfully executed trades in light of

PEC's "actual, real time recommendations." This argument imply ignores the material distinction between what "happened" and what "might have happened." As we recognized in a related context, "in determining whether to rely on a trading program to guide his decisions to enter and exit the futures market, a reasonable customer would think it material that the trading program at issue had never been tested through actual trading." *Levine v. Refco, Inc.*, (1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,488 at 36,115 (CFTC July 25, 1989). *See also CFTC v. Skorupskas,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,534 at 30,305 (E.D. Mich. 1985) (performance tables representing hypothetical or fictitious trading as actual trading violated Section 4*o*(1) and Regulation 4.41(b)).

In view of the evidence that no one actually placed orders, executed trades and earned the profits touted in the advertisements, PEC's violation of Regulation 4.41(a) is amply supported by the record. Moreover, in view of the testimony establishing that NFA limits its reviews to actual trading documents such as confirmations and monthly statements, Tr. 875-881, PEC also violated Regulation 4.41(a) by suggesting that NFA had audited the "results" of its trading.[14]

Regulation 4.41(b) required PEC to prominently display a specified disclaimer in any presentation of the performance of any simulated or hypothetical transaction in a commodity account.[15] On remand, Armstrong argues that PEC was not required to include this disclaimer in its advertisement because PEC's performance claim were based on neither hypothetical nor simulated transactions. In support of this argument, he notes that PEC's performance results were based on the actual results of real-time recommendations rather than the *post hoc* application of a trading model to historical market conditions. He contends that the transactions recommended by PEC's trading program cannot be deemed either hypothetical or simulated within the meaning of the rule, because, by its terms, the rule warns customers that simulated transactions, in general, are "designed with the benefit of hindsight." In effect, he argues that PEC's "real-time recommendations" are more like actual transactions than the hypothetical or simulated transactions covered by Regulation 4.41(b).

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[14] Armstrong argues that he did not receive adequate notice of the theory underlying the ALJ's conclusion that PEC's advertisements were deceptive. Our *de novo* analysis renders this issue moot. We note, however, that the ALJ's approach is consistent with the wording of the Second Complaint, which charged that PEC's advertisement misrepresented that NFA had "audited PEC's claimed *performance* in S&P 500 stock index futures when, in fact, no such 'audit' was ever conducted by the National Futures Association or its staff." Second Complaint, ¶ 45.

Regulation 4.41(b) does not attempt to catalogue the many material distinctions between actual transactions and those that are merely "hypothetical" or "simulated." The language, however, is sufficiently broad to encompass any transaction that is not actually executed in the market at issue. The basic purpose of Regulation 4.41(b)(1) is to alert "prospective customers to the limitations inherent in simulated and hypothetical past performance results." *Revisions of Pool Operator and Advisor Rules,* [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,188 at 24,903 (May 8, 1981). As the cautionary statement required by Regulation 4.4(b)(1) explains, when trades are not actually executed, the results may under-or-over compensate for the potential impact of certain market factors, such as lack of liquidity. This limitation is clearly applicable to the recommended transactions underlying PEC's performance claims, and the disclaimer would serve to alert clients to the limited predictive value of the performance results touted in the advertisements. Therefore, on this record, we conclude that PEC violated Regulation 4.41(b) by failing to include the required disclaimer in the challenged advertisments.

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[15] The disclaimer must reflect the following language:

> Hypothetical or simulated performance results have certain limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under-or-over compensated for the impact, if any, of certain market factor, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown.

D. *Armstrong's Liability Under Section 13(b)*

For purposes of determining Armstrong's liability for ECP's and PEC's violations, the first issue is whether Armstrong controlled these corporate entities.[16] The Commission has defined control as the "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract or otherwise." *In re Spiegel,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) § 24,103 at 34,765 n.4. *See also Monieson v. Commodity Futures Trading Commission,* 996 F.2d 852, 859 (7th Cir. 1993) ("It is the [respondent's] power that matters, not whether he exercised it by actually participating in or benefitting from the illegal acts."). The record demonstrates that Armstrong both possessed and exercised the requisite power.

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[16] A fundamental purpose of Section 13(b) is to allow the Commission to reach behind the corporate entity to the controlling individuals of the corporation and to impose liability for violations of the Act directly on such individuals as well as on the corporation itself. *In re Apache Trading Corp.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,251 at 38,794 (CFTC Mar. 11, 1992), *appeal dismissed sub nom. Clancy v. CFTC,* No. 92-4708 (11th Cir. Dec. 1, 1993).

The record clearly demonstrates Armstrong's dominant role in the governance of ECP and PEC. For example, it is uncontested that he was the president, sole director and only officer of the corporations; he hired and trained corporate employees, and established the pay rates; he wrote the reports issued by the corporations; he gave personal consultations, prepared the market analyses and conducted the seminars; and he prepared the advertisements and made trading decisions in the client managed accounts. As the Division argues, these facts readily establish control within the meaning of Section 13(b).

The next issue is whether Armstrong knowingly induced the violations or evaded knowledge by failing to act in good faith. To establish knowing inducement of a violation within the meaning of Section 13(b), the Division must show ". . . . that the controlling person had actual or constructive knowledge of the core activities that constitute the violation at issue and allowed them to continue." *In re Spiegel,* ¶ 24,103 at 34,767, n.11. *See also In re JCC, Inc.,* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080 at 41,759 (CFTC May 12, 1994) ("It is enough for the Division to show that [respondent] had the power to influence management policy and failed to do what he could to prevent the violations."). The record demonstrates that

Armstrong had knowledge of the core elements of both ECP's and PEC's violations and failed to take appropriate action to halt the wrongful conduct.[17]

Clearly, Armstrong was aware that Rudolf Wolff had agreed to pay commission rebates to ECP and that this arrangement was not described in ECP's disclosure document. In fact, Armstrong personally negotiated the terms of ECP's relationship with Rudolf Wolff, and met with Wetter and other Rudolf Wolff officials to confirm details of the commission sharing agreement. He also placed orders at Rudolf Wolff for ECP's managed accounts. Moreover, as noted above, the 1984 disclosure document advised existing or prospective managed account clients to address any guestions about the company or its managed account program to Armstrong.

The record also demonstrates that, despite his knowledge that ECP's disclosure document did not reveal the arrangement with Rudolf Wolff, Armstrong failed to correct the problem.[18]

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[17] Given our conclusion that the record establishes that Armstrong knowingly induced the violations at issue, we need not consider his challenges to the Division's claim that he also failed to act in good faith. As Section 13(b) is worded in the alternative, a respondent cannot defeat the Commission's showing of "knowing inducement" by maintaining that he acted in "good faith." *Spiegel*, ¶ 24,103 at 34,767 ("If the controlling person knowingly induces acts that amount to a violation, he will not escape liability merely because he acted in good faith.").

[18] On remand, Armstrong argues that the Commission may not infer that he knowingly induced ECP's wrongful conduct absent evidence that he wrote, edited or otherwise was involved in the drafting or formulation of the disclosure documents or the decisions not to update them. The scope of Section 13(b), however, is not limited to such direct activity. By its very language, it covers

(Cont'd)

Indeed, the record shows that Armstrong was directly involved in the decision to withhold the pertinent information from the managed account client and the Commission. As noted above, Armstrong himself negotiated the commission sharing arrangement. He reviewed the 1985 draft disclosure document which repeated the misrepresentation that ECP was not receiving rebates from any FCMs and decided not to disseminate it because it contained poor performance results for ECP. Tr. 260. More importantly, however, the record shows that Armstrong instructed Mark Lively, his employee and managed account client, to conceal the commission sharing arrangements from the managed account clients.[19] Lively's testimony establishes Armstrong's direct involvement in the decision to withhold this material information from his managed account clients. Clearly, Armstrong had actual knowledge of the core activity that constituted ECP's violation and allowed it to continue. Based on this evidence, we find that Armstrong knowingly induced ECP's violation of Sections 4b and 4*o* of the Act and Regulation 4.31.

Turning to the controlling person allegations in Count IV and V of the Second Complaint, we find that the record demonstrates that Armstrong also had knowledge of the core elements of PEC's violations. Armstrong's own testimony at the hearing shows that he prepared and/or reviewed the text of the advertisements at issue. Tr. 1336-1343. Moreover, he admitted that he knew that PEC's representations were not based on actual

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(Cont'd)
controlling persons who knowingly but "indirectly" induce wrongful conduct. As we recognized in *Spiegel, supra,* proof that a controlling person allows a known violation to continue is sufficient to establish an indirect inducement.

[19] The ALJ found Lively to be a credible witness and Armstrong chose not to challenge this determination in his appeal to the Commission. In any case, our independent review of the record leads us to the same conclusion.

trades. Tr. 1333. These facts put Armstrong on notice that the advertisements in question were likely to mislead customers about the nature of PEC's performance claims.

On remand, Armstrong contends that he did not act knowingly because (1) there were substantial grounds for believing the advertisements were accurate;[20] and (2) he relied upon advice from attorneys that neither the Commission nor NFA had jurisdiction over PECs advertisements. While we agree that the deceptive nature of the advertisements is one of the "core elements" of the violations at issue, the record supports an inference that Armstrong was aware that they created a false impression. If Armstrong had wanted prospective customers to know that the advertisements' performance claims rested on recommendations rather than actual trades, he could have communicated this fact in a simple, straightforward manner. Instead, the advertisements used such words as "we made," "bought it", "we have made," "we were aggressive buyers" and "total profits" to create the impression that the results depicted actual trading. Alternatively, even if he had good faith questions concerning the applicability of some of the warning language included in Regulation 4.41(b) to the recommendations made by PEC, he could have sought specific advice from NFA or the Commission or included those portions of the warning language that clearly applied in the advertisements. He took none of these steps, and his self-serving testimony simply does not ring true.

Similarly, the record belies Armstrong's contentions about his reliance on counsel. In assessing the credibility of such claims, we look to a number of factors, including:

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[20] In regard to PEC's violations of Regulation 4.41(a), Armstrong notes that the terms "hypothetical" and "simulated" are not specifically defined, and that he cannot be charged with knowledge of the Commission's "ex post facto" construction of those terms.

> 1) a request for advice of counsel on the legality of a proposed action, 2) full disclosure of the relevant facts to counsel, 3) receipt of advice from counsel that the action to be taken will be legal, and 4) reliance in good faith on counsel's advice.

C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1436 (10th Cir. 1988); *SEC v. Goldfield Deep Mines Co. of Nevada,* 758 F.2d 459,467 (9th Cir. 1985). Here, Armstrong conceded that the attorneys at issue were not supplied with such relevant information about PEC's activities as advertisements and promotional materials (Tr. 16, 252, 1549-1552). While Armstrong testified that counsel supplied written opinions confirming that PEC's activities were lawful (Tr. 1541-1545, 1856-1875), he neither introduced the written opinions into evidence nor offered an explanation for the missing opinions. In these circumstances, we decline to credit Armstrong's claim that he was unaware of the core elements of PEC's violative conduct.

Given Armstrong's active role in preparing the advertisements at issue, it is clear that he knowingly induced PEC's wrongful conduct. Accordingly, we find that the weight of the evidence establishes that Armstrong knowingly induced PEC's violations of Regulations 4.41(a) and 4.41(b) within the meaning of Section 13(b) of the Act.

CONCLUSION

We find Armstrong liable as a controlling person under Section 13(b) for the violations of respondents ECP and PEC. In view of this finding, we reinstate the sanctions imposed against Armstrong in our February 8, 1993 Opinion and Order. We also deny respondent Armstrong's motion to dimiss, or, in the alternative to reopen the record in this matter.

IT IS SO ORDERED.[21]

By the Commission (Chairman SCHAPIRO, and Commisioners BAIR, DIAL, TULL and HOLUM).

s/ Jean A. Webb
Jean A. Webb
Secretary of the Commission
Commodity Futures Trading
Commission

Dated: March 10, 1995

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[21] The sanctions imposed on respondent in this proceeding shall become effective 30 days after the date the order is served. A motion to stay the effect of these sanctions pending reconsideration by the Commission or review by a court must be filed within 15 days of the date this order is served. *Compare* Commission Rule 10.106.

APPENDIX C — ORDER OF THE COMMODITY FUTURES TRADING COMMISSION FILED MARCH 25, 1994

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

CFTC Docket No. 87-10

In the Matter of

MARTIN A. ARMSTRONG

ORDER

This matter comes to us on remand from the U.S. Court of Appeals for the Third Circuit. *See Armstrong v. CFTC*, No. 93-3077 (3d Cir. Dec. 21, 1993), vacating our opinion and order in *In re Armstrong*, [Current Transfer Binder] Comm. Fut. L. Rep. 25,657 (CFTC Feb. 8, 1993), and remanding for further proceedings. In accordance with the court of appeals' decision, we request additional briefing from respondent Martin A. Armstrong and the Division of Enforcement, as described *infra*.

* * *

The Commission filed two administrative complaints against respondent Martin A. Armstrong and three corporations he established to provide investment advice and related services. The first complaint, CFTC Docket No. 85-47, charged the four respondents with conducting a commodity trading advisor ("CTA") business without being registered, and with other violations. The second complaint, CFTC Docket No. 87-10, charged Armstrong and two corporate respondents with violating antifraud provisions of the Commodity Exchange Act ("Act"). In the second complaint, Armstrong was charged solely as a controlling person under section 13(b) of the Act.

The complaints were consolidated for hearing, and an Administrative Law Judge (ALJ") subsequently found the respondents liable for all violations in both complaints. The ALJ treated Armstrong and the corporations as a "single enterprise," finding their several activities and functions to be "merged and inseparable." Under that rationale, once the liability of one respondent was established as to a particular violation, the liability of all resulted. Having applied this "unitary" approach to the respondents' culpability, the ALJ then found it unnecessary to reach the issue of whether Armstrong was liable as a "controlling person," and therefore did not address section 13(b) in discussing the second complaint.

Armstrong and the corporations appealed to the Commission. Our opinion and order disposed of the second complaint first. We concluded that the ALJ had reached a "substantially correct" result on the allegations raised, and that on appeal the parties had raised no "important questions of law or policy concerning the ALJ's findings of facts and conclusions . . . ." *In re Armstrong, supra*, [Current Transfer Binder] Comm. Fut. L. Rep. at 40,145. Accordingly, we summarily affirmed the ALJ's liability determinations without opinion. The effect of the summary affirmance was to find Armstrong liable under Section 13(b), as he had been charged in the second complaint, although the opinion did not expressly reach such a conclusion.

Turning to the first complaint, we rejected as erroneous the

ALJ's single enterprise theory and treated the respondents as discrete persons. In light of the ALJ's error, we determined not to defer to the initial decision insofar as it was colored by the single enterprise theory, and undertook *de novo* factfinding in analyzing each respondent's individual liability. After an extended discussion of the charges of the first complaint, we affirmed the liability of the corporations but reversed as to Armstrong.

All four respondents then sought review in the court of appeals. The court dismissed the corporations' appeals for lack of jurisdiction, since they had ceased doing business in the Third Circuit. This left Armstrong's controlling person liability under the second complaint as the only issue to be resolved.

In vacating and remanding our opinion and order, the court held that our rejection of the ALJ's single enterprise theory "broke a critical link in the chain of reasoning" supporting Armstrong's liability for fraud under the second complaint. *Armstrong v. CFTC, supra*, slip op. at 7. The court explained that the opinion failed to state whether we accepted particular findings of fact by the ALJ or aspects of the ALJ's reasoning, despite rejecting his single enterprise theory. Without such recitations, the court found that it could not ascertain on what basis, if any, we had concluded Armstrong was liable for fraud as a controlling person. In these circumstances, the court further concluded that there were insufficient findings to hold Armstrong liable as charged under section 13(b) of the Act.

The court's opinion on remand accords the commission the options of freely adopting any of the ALJ's findings of facts or reasoning that it does not believe to be colored by the ALJ's improper unitary approach, to conduct *de novo* factfinding, to remand to the ALJ or to pursue any other proceeding it believes to be appropriate. *Id.* at 7, n.1. Given the broad record already compiled by the parties, as well as the fact that the ALJ who presided over the case is no longer available to the Commission, we have determined that the most suitable course is to invite the parties to brief the unresolved issues identified by the court, namely, whether the existing record supports (1) the conclusion that Armstrong controlled the two corporate respondents named in the second complaint; and (2) the conclusion that Armstrong did not act in good faith, or knowingly induced, the fraudulent conduct of the corporate respondents within the meaning of section 13(b) of the Act.

Briefs shall be due within 30 days of the date of this order, and no answering briefs shall be permitted. Briefs shall otherwise comply with the requirements of the Part 10 Rules.

IT IS SO ORDERED.

By the Commission (Acting Chairman HOLUM and Commissioners BAIR, DIAL and TULL).

s/ Jean A. Webb
Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission

Dated: March 25, 1994

APPENDIX D — OPINION OF THE UNITED STATES COURT OF APPEALS, THIRD CIRCUIT DECIDED DECEMBER 21, 1993

Martin A. ARMSTRONG, Petitioner,

v.

COMMODITY FUTURES TRADING COMMISSION, Respondent.

No. 93-3077.

United States Court of Appeals, Third Circuit.

Argued Nov. 10, 1993.

Decided Dec. 21, 1993.

* * *

Christopher Lovell (argued), Christopher Lovell, P.C., New York City, for petitioner.

Pat G. Nicolette, Acting Gen. Counsel, Jay L. Witkin, Deputy Gen. Counsel, James T. Kelley, Asst. Gen. Counsel (argued) and Gracemary Rizzo, Atty., Commodity Futures Trading Com'n, Washington, DC, for respondent.

Before: GREENBERG, COWEN and SEITZ, Circuit Judges.

Appendix D

OPINION OF THE COURT

SEITZ, Circuit Judge.

Martin A. Armstrong petitions for review of a decision of the Commodity Futures Trading Commission (the "Commission") holding him individually responsible as a controlling person of corporations found to have violated Commission regulations. This court has jurisdiction to review orders issued by the Commission under 7 U.S.C. § 9 (Supp. IV 1992).

I. Background

At age 13, Martin Armstrong began working at a coin and stamp dealership and was a millionaire in 1965 at the age of 15. After becoming the manager of his employer's store, he and a partner opened a collectors' store when he was 21. Armstrong progressed from gold coin investments to following commodity prices for precious metals. In 1973, he began publishing commodity market predictions as a hobby.

As his coin and stamp business declined ten years later, Armstrong spent more of his time on his commodity business. In 1983 Armstrong began accepting and fulfilling paid subscriptions for a commodity market forecast newsletter. His attorneys formed three corporations for the provision of commodity services: Princeton Economic Consultants, Inc. ("PEC"), Economic Consultants of Princeton, Inc. ("ECP"), and Armstrong Report, Inc. These corporations provided consulting services, seminar programs, written reports, telephone and telex newsline messages, and account management services.

In 1985, the Commission filed an administrative complaint against Armstrong, PEC, ECP, and Armstrong Report charging them with failure to register as commodity trading advisors, to deliver required disclosure documents to clients, and to maintain proper records. CFTC Docket No. 85-47. In 1987, the Commission filed a second administrative complaint charging that ECP failed to disclose a commission-sharing agreement, that PEC misrepresented hypothetical performance results and omitted a required disclaimer in advertisements, and that Armstrong was liable for ECP's and PEC's violations as a controlling person of those corporations. CFTC Docket No. 87-10. The proceedings were consolidated for hearing and decision.

The administrative law judge ("ALJ") issued an Initial Decision finding Armstrong and all three corporations liable on all counts charged in both dockets and proposing sanctions. *In re Armstrong*, [1987-1990 Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 24545 (Oct. 30, 1989). After a hearing, the ALJ reaffirmed the findings of fact and conclusions of law contained in his Initial Decision and imposed the tentative sanctions. *In re Armstrong*, [1987-1990 Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 24609 (Feb. 28, 1990). The sanctions banned the parties from trading for 12 months, revoked their registrations, imposed cease and desist orders, and levied civil penalties totalling $50,000.

Armstrong and the corporations appealed both the liability findings and sanctions to the Commission. They convinced the Commission that the ALJ erred by treating them as a single enterprise rather than as four discrete entities in the first complaint. *In re Armstrong*, [Current Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 25657 (Feb. 8, 1993). As a result, the Commission reversed the ALJ's finding that Armstrong was individually liable for the violations alleged in the first complaint. The Commission summarily affirmed the findings under the second complaint, including Armstrong's liability for PEC's and EPC's violations.

Armstrong and the corporations petitioned this court for review. The Commission filed a motion to dismiss on the ground that neither Armstrong nor the corporations were currently doing business in the Third Circuit as required under the jurisdictional provision of the Commodity Exchange Act. 7 U.S.C. § 9 (Supp. IV 1992). Another panel of this court dismissed the corporations' petitions for review because all have ceased doing business; it denied the motion to dismiss as to Armstrong personally. Only Armstrong's individual liability under the second complaint remains for review.

II. Compliance with APA § 557(c)

A. *The Commission's Opinion*

Armstrong complains that the Commission did not meet the requirements of the Administrative Procedure Act because it did not provide an adequate "statement of . . . findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record." 5 U.S.C. § 557(c) (1988). On questions of law, administrative judgments are generally subject to plenary judicial review. *Dill v. INS*, 773 F.2d 25, 28 (3d Cir. 1985).

The purposes of the APA provision requiring specific findings and conclusions are to prevent arbitrary agency decisions, provide parties with a reasoned explanation for those decisions, settle the law for future cases, and furnish a basis for effective judicial review. 4 Stein, Mitchell & Mezines, Administrative Law § 39.05 (June 1991). Third Circuit Court of Appeals precedent emphasizes the need for adequate findings to ensure effective judicial review and eliminate appellate speculation. *See Wensel v. Director, Office of Workers' Compensation Programs, United States Dep't of Labor,* 888 F.2d 14, 16 (3d Cir. 1989) (stating that the APA requires sufficient findings and reasoning to enable a reviewing court to understand how the ALJ reached the decision, particularly when the ALJ has rejected relevant evidence or there is conflicting probative evidence in the record); *Bethlehem Steel Corp. v. Occupational Safety & Health Review Comm'n*, 607 F.2d 1069, 1073-74 (3d Cir. 1979) (holding that, at a minimum, an ALJ's findings must provide the evidentiary basis for the legal conclusions in order to avoid appellate speculation).

An administrative agency need not provide an independent statement if it specifically adopts an ALJ's opinion that sets forth adequate findings and reasoning. *Kenworth Trucks, Inc. v. NLRB*, 580 F.2d 55, 62-63 (3d Cir. 1978). In the wake of *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 98 S.Ct. 1197, 55 L.Ed.2d 460 (1978), our decision upon rehearing in *Kenworth* held that the NLRB was not required to separately elaborate reasons after specifically adopting the ALJ's findings and reasoning underlying a bargaining order.

No particular form of adoption is required if the agency's action permits meaningful appellate review. The Seventh Circuit has concluded that an agency order stating that "The initial decision is affirmed and the proceeding is terminated" is sufficient to indicate adoption of an ALJ's entire opinion. *City of Frankfort, Ind. v. FERC*, 678 F.2d 699, 708 & n. 18 (7th Cir. 1982). The D.C. Circuit similarly accepted summary affirmance of enumerated issues by an agency in *Cities of Bethany v. FERC*, 727 F.2d 1131, 1144 (D.C. Cir.), *cert. denied*, 469 U.S. 917, 105 S.Ct. 293, 83 L.Ed.2d 229 (1984).

In the case before us, however, the Commission has not clearly adopted the ALJ's opinion. The Commission's entire opinion regarding the second complaint stated:

> Our review of the record and the briefs submitted by the parties establishes that the ALJ reached a substantially correct result on all the allegations raised in the Second Complaint. Because we also conclude that the parties have not raised important questions of law or policy concerning the ALJ's findings of fact and conclusions on these allegations, we affirm the Second Complaint without opinion.[2]
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>
> 2. The ALJ's decisions shall neither be cited as Commission precedent in any Commission proceeding, nor deemed an expression of the Commission's views on the issues raised in the Second Complaint.

In re Armstrong, [Current Transfer Binder] Comm.Fut.L.Rep (CCH) ¶ 25657, at 40145 & n. 2.

Summarily affirming the ALJ's opinion as "substantially correct" is insufficient because it does not permit intelligent appellate review. *Kenworth, City of Frankfort*, and *Cities of Bethany* approved summary affirmances when the agency adopted an entire opinion or specified parts of an opinion. However, the Commission's conclusion that the ALJ reached a "substantially correct" result leaves questions about which specific findings or conclusions by the ALJ were incorrect.

The footnote disclaiming the ALJ's decision as an expression of the Commission's views further undermines the Commission's assertion before us that it adopted the entire opinion. We assume that the Commission has the power to determine which of its decisions may be cited as precedent in future proceedings before it. However, the declaration that the opinion does not represent the Commission's views erodes our confidence that the Commission carefully considered and adopted each of the ALJ's findings and conclusions as contemplated by *Kenworth*.

We hold that a summary affirmance of all or part of an ALJ's opinion must leave no guesswork regarding what the agency has adopted. A decision by an ALJ that is only "substantially correct" should be fully correct by the time an agency imprints its seal of approval.

B. *The ALJ's Opinion*

Although a remand is warranted based on the adoption issue alone, we proceed to review the Commission's and the ALJ's opinions in order to prevent an immediate return of the case to this court. *Cf. City of Frankfort*, 678 F.2d at 708 (reasoning that a remand is not justified for one finding of fact that results only in the agency officially "adopting" the ALJ's entire opinion).

1. The Single Enterprise Theory

In his Initial Decision, the ALJ concluded that Armstrong and the three corporations acted as a single enterprise. *In re Armstrong*, [1987-1990 Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 24545, at 36343-45. The Commission, however, could not "endorse the ALJ's novel approach" because it was supported neither by Commission precedent nor by the complaint filed against the respondents. *In re Armstrong*, [Current Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 25657, at 40145. Because the ALJ did not assess each respondent's individual liability, The Commission undertook de novo factfinding under the first complaint. *Id.* The Commission had already "affirmed" the ALJ's opinion regarding the second complaint and did not address whether the ALJ's alter ego theory infected the liability conclusions in that docket. *See id.*

Reversal of the ALJ's unitary approach to liability broke a critical link in the chain of reasoning that concluded that Armstrong was liable under the second complaint. Although the ALJ did not mention the single enterprise theory in his discussion of the charges under the second complaint, he also did not discuss Armstrong's actions apart from the corporations'. Read in light of the Commission's decision, the Initial Decision no longer contains a framework of findings and reasoning to support imposing sanctions against Armstrong individually.[1]

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[1] The Commission's opinion finds that

> the ALJ erred by failing to assess each respondent's individual obligation under Section 4m of the [Commodity Exchange] Act.
>
> In light of the ALJ's error, we cannot follow our normal practice of according general deference to the presiding officer's assessment of the factual record. In order to analyze each respondent's individual liability, we have undertaken *de novo* fact-finding [regarding the charges in the first complaint] where the judge's findings are colored by his improper unitary approach. . . .

(Cont'd)

2. *Controlling Person Liability*

The only theory under which Armstrong was charged with individual liability in the second complaint was a controlling person as defined in section 13(b) of the Commodity Exchange Act. This section provides:

> Any person who, directly or indirectly, controls any person who has violated . . . any of the rules, regulations, or orders issued pursuant to this chapter may be held liable for such violation in any action brought by the Commission to the same extent as such controlled person. In such action, the Commission has the burden of proving that the controlling person did not act in good faith or knowingly induced, directly or indirectly, the act or acts constituting the violation.

7 U.S.C. § 13c(b) (1988).

Neither the ALJ's Initial Decision nor the Commission's

(Cont'd)
In re Armstrong, [Current Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 25657, at 40145 (citation omitted). Because we are unsure of the Commission's intended effect on the ALJ's Initial Decision, we assume it vacated the entire subsection I(A) discussing the single enteprise theory. *See In re Armstrong*, [1987-1990 Transfer Binder] Comm.Fut.L.Rep. (CCH) ¶ 24545, at 36343-45, paras. 7-11. On remand, the Commission is free to adopt any of the ALJ's findings of fact or reasoning that it does not believe to be "colored by [the ALJ's] improper unitary approach," to conduct further *de novo* factfinding, to remand to the ALJ, or to pursue any other proceeding it believes to be appropriate.

opinion addressed Section 13(b). As discussed above, the Administrative Procedure Act requires an adequate "statement of . . . findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record." 5 U.S.C. § 557(c) (1988). We do not understand how a statement of conclusion on a material issue of law can be adequate without mentioning the statutory provision or its language.

Section 13(b) requires at least two findings before concluding a respondent is liable as a controlling person: (1) that the respondent controlled a violator; and (2) that the controlling persons did not act in good faith or knowingly induced the violation. First, the Commission contends that the ALJ's statement that Armstrong "had and exercised full domination and control over all operations of" ECP and PEC is a sufficient finding that Armstrong controlled the corporations. However, this statement was made as part of the single enterprise discussion that the Commission vacated; its continuing validity is at least subject to question. Second, the Commission's appeal brief recites evidence in the record from which the ALJ could have found that Armstrong knowingly induced the violations. Nevertheless, there is still no finding by the ALJ or the Commission that Armstrong did knowingly induce the violations. Finally, and most importantly, there is no conclusion that Armstrong is liable as a controlling person under Section 13(b). Without a conclusion that Armstrong is liable for violations with which he was charged, Armstrong may not be individually penalized.

III. Conclusion

We hold that the Commission's opinion does not comply with Section 557(c) of the Administrative Procedure Act because: (1) deeming an ALJ's opinion to be "substantially correct" does not rise to the level of adoption permitted by *Kenworth*; and (2) due to the ambiguous affirmance of the ALJ's opinion by the Commission and the vacation of the single enterprise theory resulting in the absence of findings supporting and a conclusion of "controlling person" status, there are insufficient findings to hold Armstrong liable as charged under Section 13(b) of the Commodity Exchange Act. Because it will be necessary for the Commission to reconsider Armstrong's liability as it considers more specific findings, reasons, and conclusions, we do not reach the weight of the evidence issues raised by Armstrong.

The decision of the Commission will be vacated and the matter remanded to the Commission for further appropriate proceedings.

APPENDIX E — OPINION AND ORDER FILED FEBRUARY 8, 1993

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

CFTC Docket Nos. 85-47, 87-10

In the Matter of:

MARTIN A. ARMSTRONG, PRINCETON ECONOMIC CONSULTANTS, INC., ARMSTRONG REPORT, INC. AND ECONOMIC CONSULTANTS OF PRINCETON, INC.

OPINION AND ORDER

This enforcement action arose from consolidated administrative complaints against Martin A. Armstrong, Princeton Economic Consultants, Inc. ("PEC"), Armstrong Report, Inc. ("Report Inc."), and Economic Consultants of Princeton, Inc. ("ECP"). The first complaint ("First Complaint") was issued on September 30, 1985 in CFTC Docket No. 85-47. It charged the respondents with violating (1) the registration provisions of Section 4m of the Commodity Exchange Act ("Act" or "CEA") (Counts One through Four), (2) the disclosure provisions of Regulation 4.31(a) (Counts Five and Six); and (3) the recordkeeping provisions of Regulation 4.32 (Counts Seven and Eight). A second complaint ("Second Complaint") was issued against Armstrong, PEC, and ECP by the Commission on June 23, 1987 in CFTC Docket No. 87-10. This complaint alleged that: (1) ECP violated Section 4b(A) and 4*o*(1) of the Act and Regulation 4.31(b) by failing to disclose to managed-account clients the existence of a commission-rebate agreement with a futures commission merchant (Counts One through Three); (2) PEC violated Regulations 4.41(a) and (b) by publishing advertisements which misrepresented hypothetical performance results as actual trading (Counts Four and Five); and (3) Armstrong is liable as a controlling person under Section 13(b) for ECP's and PEC's violations (Counts one through Five).

In his initial decision dated October 30, 1989, the Administrative Law Judge ("ALJ") treated respondents as a "single enterprise" and found them liable for all violations alleged in the consolidated complaints. *In re Armstrong*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,545 (Oct. 30, 1989) ("Initial Decision"). The Administrative Law Judge ("ALJ") sanctioned the respondents by entering cease and desist orders and 12 month trading bans against them, and revoking their registrations. *In re Armstrong*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,609 (Feb. 28, 1990) ("Initial Decision as to Sanctions"). He also assessed civil monetary penalties of $24,000 against Armstrong, $12,000 against ECP, $10,000 against PEC, and $4,000 against Report Inc.

On appeal, respondents argue that the ALJ erred by treating them as a single enterprise rather than four discrete entities. They also challenge various aspects of the ALJ's liability and sanctions analysis. The Division of Enforcement ("Division") argues that the Initial Decision should be affirmed in all respects. For the reasons discussed below, we affirm in part and reverse in part.

Appendix E

DISCUSSION[1]

CFTC Docket No. 87-10

Our review of the record and the briefs submitted by the parties establishes that the ALJ reached a substantially correct result on all the allegations raised in the Second Complaint. Because we also conclude that the parties have not raised important questions of law or policy concerning the ALJ's findings of fact and conclusions on these allegations, we affirm the Second Complaint without opinion.[2]

CFTC Docket No. 85-47

As noted above, in determining that respondents Armstrong, ECP, PEC, and Report Inc. should have been registered as commodity trading advisors ("CTAs") pursuant to Section 4m of the Act, the ALJ treated all respondents as a "single enterprise." He rested his analysis on Section 2(a)(1)(A)(iii) of the Act and his finding that respondents' activities and functions were "merged and inseparable." *In re Armstrong*, ¶ 24,545 at 36,343. Respondents challenge this approach as fundamentally flawed.

While the record demonstrated significant overlap among the activities of the various respondents, we cannot endorse the ALJ's novel approach to resolving this problem. The ALJ cited no Commission precedent which would authorize such a unitary approach to liability. Nor does the language or structure of the First Complaint suggest that our focus was on respondents' liability as a group. Accordingly, we find the ALJ erred by failing to assess each respondent's individual obligation under Section 4m of the Act.

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[1] After the Initial Decision was issued in this case, some of the sections of the Act were redesignated by the Futures Trading Practices Act of 1992, H.R. 707, 102 Cong., 2d Sess., P.L. 102-546 (enacted Oct. 28, 1992). The remainder of this decision refers to the redesignated statutory sections.

[2] The ALJ's decisions shall neither be cited as Commission precedent in any Commission proceeding nor deemed an expression of the Commission's views on the issues raised in the Second Complaint.

In light of the ALJ's error, we cannot follow our normal practice of according general deference to the presiding officer's assessment of the factual record. *Compare In re Apache Trading Corp.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,251 (CFTC Mar. 11, 1992). In order to analyze each respondent's individual liability, we have undertaken *de novo* fact-finding where the judge's findings are colored by his improper unitary approach. We organize our discussion on a count by count basis.

Count One: That Armstrong violated Section 4m of the Act by acting as a CTA without being registered with the Commission from March 1, 1983 through on or about July 1, 1985.

Respondent Armstrong, who first registered with the Commission on July 2, 1985 as a commodity pool operator and as an associated person of ECP,[3] decided in March 1983 to develop, advertise, and disseminate a financial publication known as the *Armstrong Report*. *In re Armstrong*, ¶ 24,545 at 36,342. Beginning in March 1983, the *Armstrong Report* was mailed to subscribers once a month or every other month. Tr. 1064; Div. Exs. 44, 45, 46, 93, 94, 96, 98. At the same time, Armstrong offered a telephone newsline service for subscribers to the *Armstrong Report* which provided trading advice.

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[3] Armstrong is not currently registered in any capacity. He was previously registered as an associated person of Manning Stoller Commodities, Inc., a futures commission merchant.

In May 1983, Armstrong began conducting business through three new corporate entities, PEC (incorporated on May 12, 1983), Report Inc. (incorporated on May 20, 1983) and ECP (incorporated on May 27, 1983). PEC served as a holding company, owning all shares in its two subsidiaries, Report and ECP. Armstrong was the principal, sole stockholder, president and director of PEC, and the president and director of ECP and Report. *In re Armstrong*, ¶ 24,545 at 36,342. One of the corporate respondents, Report, published the *Armstrong Report* and another financial publication, the *Armstrong Financial Report*. Both of these publications offered analyses and advice about trading commodity futures contracts and offered subscribers a telephone newsline service which provided specific commodity futures trading recommendations. Another corporate respondent, ECP, provided managed commodity futures trading account services and personal consultation services to people who responded to advertisements in the *Armstrong Report*. Finally, the third corporate respondent, PEC, offered seminar programs and personal consultation services to people who responded to advertisements in the *Armstrong Report*.

Count One of the First Complaint charged Armstrong with violating Section 4m of the Act by acting as a CTA without being registered with the Commission for the period March 1, 1983 through July 1, 1985.[4] The record shows that Armstrong engaged in some limited investment advisory activities pre-

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[4] Section 1a(5) of the Act defines a CTA as:

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(A) IN GENERAL. — Except as otherwise provided in this paragraph, the term "commodity trading advisor" means any person who --

(i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value or the advisability of trading in --

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market;

(II) any commodity option authorized under section 4c; or

. . . .

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

(B) EXCLUSIONS. — Subject to subparagraph (C), the term commodity trading advisor" does not include --

. . . .

(iv) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees;

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incorporation. Div. Ex. 93, 94, Tr. 404-407. From March 1983 until May 1983 when the three corporate entities were formed, the *Armstrong Report* was published by Armstrong personally. As noted above, Armstrong also made available a telephone newsline service for the subscribers to the *Armstrong Report* during the two month period prior to incorporation. The Initial Decision did not address these pre-incorporation activities. However, after examining the record ourselves, we find that it is unclear from these early issues of the *Armstrong Report* that Armstrong was providing advice about trading in commodity futures contracts or options rather than trading in the physical gold or silver metals market. Similarly, the testimony of record

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> (C) INCIDENTAL SERVICES. — Subparagraph (B) shall apply only if the furnishing of such services by persons referred to in subparagraph (B) is solely incidental to the conduct of their business or profession.
>
> . . . .

The Act further provides for the registration of a CTA in Section 4m(1):

> It shall be unlawful for any commodity trading advisor . . . , unless registered under this Act, to make use of the mails or other means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor . . . : *Provided*, That the provisions of this section shall not apply to any commodity trading advisor who, during the course of the proceeding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading advisor . . . .

is inadequate to support a finding that the investment advice Armstrong provided over the telephone newsline service during the pre-incorporation stage related to commodity futures contracts or options. Thus, we conclude that the weight of the evidence does not support a finding that Armstrong's limited pre-incorporation activities come within the definition of CTA in Section 1a(5) of the Act.

Armstrong argues that after the corporate entities were formed in May 1983, he performed his CTA-related activities as a representative of the corporations rather than personally. To make a finding of liability against Armstrong under Count One of the First Complaint, the ALJ "pierced the corporate veil" and found Armstrong individually liable as the *alter ego* of the corporate respondents. *In re Armstrong*, ¶ 24,545 at 36,343-44.[5]

However, this theory of liability was not raised in Count One of the First Complaint which charged Armstrong with acting as a CTA without being registered as such. Nor was it relied upon by the Division in its pre-hearing memorandum.[6] As we noted in

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[5] *See King v. First London Commodity, Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,201 (CFTC May 25, 1984) (factors considered in piercing the corporate veil are thin or inadequate capitalization, failure to observe the corporate formalities, non-payment of dividends, the insolvency of the debtor corporation at the time the transactions at issue took place, syphoning of funds of the corporation by the dominant stockholder, the existence of officers or directors that have no functional role, absence of corporate records, and the fact that the corporation is merely a facade for the operations of the dominant stockholder).

[6] The Division first tentatively raised the theory of "piercing the corporate veil" in its post-hearing memorandum. There, the Division states that "the simple act of incorporating PEC, Report Inc. and ECP in May 1983 did not

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another case, a substantial showing is required to pierce the corporate veil. *See Hwang v. Bull Market Commodities, Inc.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,773 at 34,029 (CFTC July 7, 1987) *quoting Pardo v. Wilson Line of Washington, Inc.*, 414 F.2d 1145, 1149-1150 (D.C. Cir. 1969) ("Piercing a corporate veil is a task which a court undertakes reluctantly; there is a presumption of corporate regularity which usually requires the party seeking to have the corporate entity disregarded to come forward with a substantial showing that the corporation was really a dummy for the person sought to be held liable"). Where, as here, the respondents had no notice of this theory of liability, we refuse to rely upon it. *See Haluschak v. Peterson*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,643 at 33,669 (CFTC May 27, 1987).[7] Accordingly, we reverse the ALJ's finding under Count One of the First Complaint that Armstrong is individually liable under Section 4m of the Act for failing to register with the Commission as a CTA for the period from March 1, 1983 through July 1, 1985.[8]

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necessarily remove Armstrong or his activities from the purview of Section 2(a)(1)(A) and 4m of the Act." DOE's Post-Hearing Memorandum, p. 19 (emphasis added). Similarly, the Division contended in its post-hearing memorandum that "an argument can be made that, in 1983 and 1984, PEC, Report Inc. and ECP were no more than the *alter egos* of Armstrong." *Id.* (emphasis added).

[7] Given this conclusion, we need not determine whether a piercing the corporate veil theory is applicable in an enforcement case. *Compare In re Lincolnwood Commodities, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,986 at 28,258 n.113 (CFTC Jan. 31, 1984).

[8] Because the First Complaint limited its focus to Armstrong's status as a CTA, we do not consider whether Armstrong's activities required registration under the Act in any other capacity.

Count Two: That Report, Inc. violated Section 4m of the Act by acting as a CTA without being registered with the Commission from May 20, 1983 through on or about July 1, 1985.

After Report Inc. was incorporated in May 1983, it offered a variety of advisory services. First, it sold several financial publications. One of these publications, the *Armstrong Report*, contained analyses and advice about trading on commodity futures contracts including, among other things, gold and silver futures contracts on the Commodity Exchange, Inc. ("COMEX") and platinum futures contracts on the New York Mercantile Exchange, Inc. ("NYMEX"). Div. Ex. 45, 46. The *Armstrong Report*, published monthly or bimonthly, predicted prices and price movements in the precious metals market. *In re Armstrong*, ¶ 24,545 at 36,345. Initially, there were approximately 500 subscribers to the *Armstrong Report*, which was distributed by mail. The cost of a subscription was between $150 and $500. By 1984, there were approximately 1,000 subscribers and the subscription fee increased to as high as $1,500. *Id.* Sometime in February 1984, Report Inc. began to advertise and send to subscribers another financial publication called the *Armstrong Financial Report*. Tr. 211. This publication predicted prices and price movements in the foreign currency futures markets. Tr. 211; Div. Ex. 49.

Second, Report Inc. also made available to each person with an annual subscription to the *Armstrong Report* a taped telephone newsline service known as the "Armstrong Newsline." *In re Armstrong*, ¶ 24,545 at 36,345. In addition, commencing in February 1984, Report Inc. also provided subscribers to the *Armstrong Financial Report* with access to a taped telephone newsline service called the "Armstrong

Financial Newsline." Report Inc. charged additional annual subscription fees for the newsline services. Tr. 181; Div. Ex. 49. Through these newsline services, Report Inc. provided subscribers with specific trade recommendations concerning the purchase or sale of various commodity futures contracts. Div. Exs. 50, 100. These newsline services were updated from two to five times daily. Div. Ex. 22, 28, 41, 42, 47.

Third, Report Inc. also offered personal consultation services for fees ranging from $1,500 to $4,000 per hour. Div. Ex. 18-20, 22-29, 41 at 4, 44-45, 95-96. One of the subscribers to the *Armstrong Report*, Mark M. Lively, became a personal consultation client of Report Inc. as a result of an advertisement in that publication. Tr. 421-27. Indeed, Report Inc. promoted the "personal consultation services" in advertisements published in *Barron's* and *Futures* magazines and in the *Armstrong Report* itself. Div. Exs. 19-29.[9] In 1984 and 1985, Report Inc. sent subscribers to the *Armstrong Report* a 25-page manual entitled "How to Use the Armstrong Report" (the "How to Use Manual"). Div. Ex. 41. In that manual, Report Inc. stressed that "[o]ur services are consultation oriented" and acknowledged that "we are not a newsletter in the traditional sense." *Id.* at 20-21. In addition to the personal consultation services, Report Inc. also provided trading advice to at least one of the managed account clients, John DeBlois. When De Blois first became a managed account client, he received his account statements from, and paid commissions to, Report Inc. Div. Ex. 103, 107.

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[9] Report Inc. advertised these personal consultation services extensively. For example, in the June 20, 1983 advertisement in *Barron's* (Div. Ex. 19), Report stated that:

> The Armstrong Report is proud of the fact that we are far more than just a newsletter. We provide economic consultation to individuals, banks, corporations, metal dealers, jewelry manufacturers, photo industry, and even governments. Our rates may be the highest in the world, but our clients testify that we are also the best.
>
> We offer personal consultation that gets you immediate access to analysis that is billed to your account for the time that you use only on a per minute basis. We offer seminars for a weekend at the cost of $500.

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In the Initial Decision, the ALJ found that it was likely the Commission would interpret Section 1a(5)'s definition of a CTA in a manner consistent with the Supreme Court's interpretation of the Investment Advisers Act of 1940 ("IA") in *Lowe v. SEC*,

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Along these same lines, in an advertisement in *Barron's* on October 10, 1983, Report Inc. specified that:

> The Armstrong Report offers more than mere printed words. We offer a daily newsline that updates three times each day during market hours with detailed explanations as to why, when, how and where to you should be acting in Gold, Silver, Platinum and the Dow. We can offer a portfolio trading system that has turned a profit every time in the past three years and we will teach this system at seminars throughout the world. We offer personal consultation facilities at the rate of $2,000 per hour which is billed on a per minute basis and will gain you instant access to an unbiased opinion during the darkest hours of trading.

Div. Ex. 25.

472 U.S. 181 (1985). On this basis, he declined to adopt the Division's position that proof respondents had provided publications, subscription services, and other non-personal advice about commodity futures contracts and options to hundreds of customers was sufficient to establish their duty to register as CTAs under the Act. *In re Armstrong*, ¶ 24,545 at 36,346. Nevertheless, because the record established that respondents had offered personalized CTA services, the judge rejected respondents' claim that a finding of liability was precluded by either the Supreme Court's holding in *Lowe* or the free speech protection guaranteed by the First Amendment. *Id.*, ¶ 24,545 at 36,353. According to the ALJ, by their conduct, respondents held themselves out generally to the public as commodity trading advisors by expressing an essentially unrestricted willingness to provide personalized commodity trading advisor services. *Id.*, ¶ 24,545 at 36,352. Because the record established that respondents' personalized CTA services were their major endeavor rather than a casual or accessory part of their publishing efforts, the ALJ concluded that the Act's exclusion of certain publishers or producers of print or electronic data of general and regular dissemination from the definition of CTA did not excuse respondents' failure to register. *Id.* at 36,352.

On appeal, respondents reiterate many of the points they raised before the ALJ. They argue that the Commission must broadly construe Section la(5)'s exclusion of certain publishers from the definition of CTA in light of the Supreme Court's interpretation of a similar exclusion from the IA in its *Lowe* decision.[10] Respondents' Appeal Brief, pp. 29-39. In addition, respondents maintain that a broad construction of the exclusion is necessary to avoid a conflict between the requirements of the Act and the First Amendment's protection of commercial speech.

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[10] Specifically, respondents argue that Report Inc. qualifies for the exclusion from the CTA definition in Section 1a(5)(B)(iv) of the Act for "(iv)

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In opposing respondents' appeal, the Division challenges their claim that the Supreme Court's *Lowe* decision should guide the Commission's interpretation of the exclusion for certain publishers set forth in Section 1a(5) of the Act. Even if a broad interpretation of the exclusion is appropriate, it continues, the record supports the ALJ's determination that Report Inc. was acting as a CTA by offering personalized services and did not qualify for either an exclusion or exemption from Section 4m's registration requirement.

For the reasons discussed below, we conclude that a broad construction of Section la(5)'s exclusion of certain publishers from its definition of a CTA is not mandated by the Supreme Court's *Lowe* decision. After reviewing the record, we affirm the ALJ's conclusion that Report Inc. was providing personalized services that required registration as a CTA on and after May 20, 1983, when it was incorporated and became the publisher of the *Armstrong Report*.

A. *Report Inc.'s Direct, Personalized CTA Activities*

As noted above, Report Inc. offered personal consultation services for fees ranging from $1,500 to $4,000 per hour. The

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the publisher or producer of any print or electronic data of general and regular dissemination, including its employees. . . ." This exclusion applies only if "the furnishing of such services by [such] persons is solely incidental to the conduct of their business or profession." Section 1a(5)(C) of the Act.

record demonstrates that one of the customers of the *Armstrong Report* became a personal consultation client as a result of an advertisement in that publication. The record also demonstrates that Report Inc. provided trading advice, and sent account statements to another subscriber of the *Armstrong Report* who later became a managed account client. There is no question that these activities bring Report Inc. within the definition of a CTA under Section 1a(5) of the Act. *See generally Damiani v. Futures Investment Company, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) 21,097 at 24,417-19 (CFTC Sept. 3, 1980); *CFTC v. Savage*, 611 F.2d 270, 279-80 (9th Cir. 1979). Through this conduct, Report Inc. acted as a person "who, for compensation or profit, engages in the business of advising others, . . . directly . . . , as to the value of or the advisability of trading in . . . contract[s] of sale of [commodities] for future delivery made or to be made on or subject to the rules of [one or more] contract market[s] . . ." and thus, absent an applicable exclusion, would be a commodity trading advisor as defined in the Act.[11] As discussed below, we find that neither the exemptions from the requirement to register nor the exclusions from the definition of a CTA apply to Report Inc.'s activities.[12] Consequently, by virtue of its direct CTA activities, Report Inc. violated Section 4m of the Act.

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[11] In this regard, it is clear that the words "advising others" includes a person who originates commodity trading advice.

[12] Even under the IA, the exclusion for publishers applies to "entirely impersonal" communications and does not exempt personal consultations with investors from the coverage of that act. *Cf. Lowe v. SEC*, 472 U.S. 181, 210 (1985); *SEC v. R.G. Reynolds Enterprises, Inc.*, 952 F.2d 1125, 1136 (9th Cir. 1991).

B. *Report Inc.'s Publications and Newsline Services*

As discussed above, Report Inc. published two commodity advisory newsletters and offered two recorded telephone newsline services providing specific commodity futures and options contracts trading recommendations to the public. Respondents contend that the Commission's attempt to regulate Report Inc.'s publications and newslines raises the constitutional concerns underlying the Supreme Court's *Lowe* decision. For this reason, they argue that the Court's interpretation of the IA's exclusionary language in *Lowe* should guide our application of Section 1a(5)'s exclusionary language in this case.

In *Lowe*, after reviewing the language and legislative history of § 203(c) of the IA, the Supreme Court held that Congress had excluded publishers of generalized securities advice from its definition of an investment adviser. Respondents, however, have failed to establish that the language of Section 1a(5) mandates a similar result under the Act. Indeed, while the definition of a CTA in Section 1a(5) of the Act bear some similarity to the definition of an "investment adviser" in Section 202(a)(11) of the IA, the exclusionary language included in Section 1a(5) of the Act is significantly different from the language underlying the Court's holding in *Lowe*.

The majority in *Lowe* focused its opinion on the IA's exclusion for "the publisher of a bona fide newspaper, magazine or business or financial publication of general and regular circulation." While there is a facial parallel between this language and the Act's exclusion for "the publisher or producer of any print or electronic data of general and regular dissemination,"[13] all of Section 1a(5)'s exclusions are limited by a proviso in Section 1a(5)(C) that does not affect the exclusion for certain publishers in the IA. This proviso states that "the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession." Given this clear distinction between Congress' exclusionary language in Section 203(c) of the IA and Section 1a(5) of the Act, we are not persuaded that the Supreme Court's holding in *Lowe* mandates a broad construction of the exclusion from the definition of CTA for certain publishers.

Having rejected respondents' statutory argument, we turn to their constitutional claims. As a general rule, an administrative agency lacks authority to consider the constitutional validity of the statute which it administers. *In re American International Trading Company*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,127 at 24,568 (CFTC Nov. 26, 1980) and cases cited therein. Instead, an agency presumes that its statutory mandate is constitutionally valid. As the ALJ found, these questions are more appropriately left for the courts. Thus, we decline to address respondents' assertion that the CTA provision of the Act is unconstitutional.

C. *The "Solely Incidental" Exclusion*

In addition to these legal challenges, respondents argue that

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[13] When Section 2(a)(1)(A) was originally enacted in 1974, its exclusion for publishers was essentially identical to the language of Section 203(c) of the IA. Several years later, however, Congress amended the language to specify that "the publisher or producer of any print or electronic data of general and regular dissemination . . . ." was excluded from the definition of a CTA. *See* the Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (1983).

Report Inc.'s CTA services were solely incidental to the conduct of its publishing business. There is no abstract numerical standard or percentage of business that defines the meaning of "solely incidental." In analyzing this issue, we look to the nature of the business and the factual context in which the advisory services are rendered. Here, Report Inc.'s financial publications and the telephone newsline services were largely devoted to advice about trading commodity futures or option contracts. Certainly, Report Inc.'s commodity advice, far from being "solely incidental" to its publishing business, was the very point of that business. In sum, we find that the furnishing of CTA services by Report Inc. was not solely incidental to the conduct of its business.[14]

D. *Exemptions from the Section 4m Registration Requirement*

Our review of the record also discloses that there is no doubt that Report Inc. held itself out generally to the public as a CTA. As discussed above, in numerous advertisements in 1983 and 1984 in *Barron's* and *Futures* magazines, Report Inc. represented that it made specific trading recommendations about commodity futures and options contracts and provided personal consultations. Similarly, Report Inc. provided trading advice to more than 15 people a year. There were approximately 500 to

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[14] *See generally* CFTC Staff Interpretative Letter No. 75-3 [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,090 (July 31, 1975); CFTC Staff Interpretative Letter No. 75-4 [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,091 (Aug. 11, 1975) (a company which published a newsletter in which a substantial number of issues were devoted to analyses of the commodity markets and specific trading recommendations was providing services fundamental, rather than solely incidental, to the company's business); CFTC Staff Interpretative Letter No. 76-1 [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,135 at 20,906 (Feb. 26, 1976).

1,000 persons who subscribed to Report Inc.'s services during the relevant time period. For these reasons, Report Inc. does not qualify for an exemption from the registration requirements under Section 4m of the Act. Accordingly, the ALJ's determination in Count Two of the First Complaint is sustained.

> *Count Three: That ECP violated Section 4m of the Act by acting as a CTA without being registered with the Commission from September 1, 1983 through on or about July 1, 1985.*

Section 4m of the Act makes it unlawful for a CTA, unless properly registered with the Commission-, to make use of the mails or any other means or instrumentalities of interstate commerce in connection with its business. An exemption under Section 4m(1) is available to a CTA who, during the course of the preceding 12 months, (1) has not furnished commodity trading advice to more than 15 persons *and* (2) does not hold itself out generally to the public as a CTA. To qualify for the exemption, both conditions must be met.

ECP, which was incorporated on May 27, 1983, was a subsidiary of the holding company, PEC. *In re Armstrong*, ¶ 24,545 at 36,342. ECP was registered with the Commission as a commodity trading advisor from July 2, 1985 until July 31, 1986. *Id.* It has ceased doing business and is not currently registered in any capacity. *Id.*

ECP, through respondent Armstrong, was responsible for managing client accounts and providing personal consultation services. *Id.* at 36,344. From September 1983 through July 1985, clients of ECP opened accounts at the futures commission merchant, Rudolf Wolff Commodity Brokers, Inc. ("Rudolf Wolff"). Most of these clients executed powers of attorney in favor of ECP. Div. Ex. 57-67. ECP's managed accounts traded, among other things, gold and silver futures contracts on the COMEX and platinum futures contracts on the NYMEX. As compensation for managing the accounts, ECP received a 20 percent performance fee and an additional 6 percent management fee. *In re Armstrong*, ¶ 24,545 at 36,345.

In addition to the managed account program, ECP, through personal consultations conducted by Armstrong, also advised others for a fee about trading commodity futures contracts or options. *Id.* at 36,345. Indeed, ECP entered into contracts for personal consultation services with subscribers to the *Armstrong Report* and managed account clients. Tr. 182-183; Div. Exs. 51, 52. These personal consultation services provided "trading advice at the time or at the moment" (Tr. 183) concerning gold, silver, and platinum commodity futures contracts or options. Tr. 181, 185; Div. Ex. 51.

In the initial decision, the ALJ found that the respondents had at least 17 clients to whom they were furnishing managed account advice or consultation advice. *In re Armstrong*, ¶ 25,545 at 36,348. On appeal, respondents assert that ECP was exempt from registration because it did not advise more than the 15 persons limited by Section 4m of the Act. In reply, the Division claims that ECP advised at least 17 persons.

We need not resolve the parties' differing views on this point. Even if ECP did not furnish commodity trading advice to more than 15 persons, we find that ECP still operated as a CTA in violation of Section 4m because it held itself out or was held out publicly by its affiliated entities as a CTA.[15] *See generally In re Armstrong*, ¶ 24,545 at 36,348-49.

In 1984 and 1985, new subscribers to the *Armstrong Report* were sent either a 25-page "How To Use Manual" or a 4-page sales brochure (the "Sales Brochure") written by or under the supervision of Armstrong. *Id.* at 36,349-51. Both of these documents contained promotional descriptions of ECP's personal consultation services and managed account program. In addition, respondent PEC held weekend seminars approximately four times each year which were attended by 20 to 30 people. Tr. 245-247, 438. At these seminars, respondent Armstrong solicited clients for ECP's managed account programs. Tr. 248, 438-39.

Consequently, we conclude that by conducting these promotional and solicitation activities for its commodity futures and options managed accounts and personal consultation services, ECP was holding itself out generally to the public or allowing its affiliated entities to hold ECP out to the public as a CTA and was not exempt from the Section 4m registration requirement.

The respondents argue that the limited acceptance for two years (1983-1985) of only 15 managed accounts is evidence that ECP did not successfully hold itself out as a CTA. Similarly, they contend that ECP did not hold itself out generally to the public as a CTA because the sales brochure indicates that the availability of the services is restricted to "investors with a minimum capital investment of $1,000,000." We disagree. An entity holds itself out as a CTA through such conduct as promoting advisory services through mailings, directory listings, and stationery, or otherwise initiating contacts with prospective clients.[16] For this reason, we find that ECP held itself out generally to the public as a CTA.

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[15] On appeal, respondents have not raised any arguments that the other entities were actually "holding out" ECP as a CTA rather than ECP holding itself out as a CTA. We need not dwell on this issue further because a CTA is responsible for "holding out" by its agents pursuant to Section 1a(5) of the Act.

Respondents also argue that while the ALJ relied on the period from October 1983 though October 1984 in determining that respondents managed 15 accounts, all of the advertisements cited by the ALJ for "holding out to the public" purposes occurred prior to October 1983 except one. Since respondents have conceded that at least one of the advertisements occurred during the relevant time period, we need not further address this argument. In addition, respondents also maintain that (1) the ALJ improperly characterized certain statements in the sales brochure (Div. Ex. 42) as solicitations; (2) none of the contents of any of the advertisements mentioned managed accounts, and (3) the "How to Use Manual" was never used or was used, at most, for one week. We find that the record flatly contradicts these assertions. Div. Exs. 41, 42; Tr. 222-234. Finally, respondents argue that the ALJ relied exclusively on witnesses who are not credible, Mark Lively and Denise Maciolek. Despite respondents' assertion, the ALJ relied on both documentary and testimonial evidence in determining that ECP held itself out to the public as a CTA. He did not rely exclusively on the testimony of Lively and Maciolek. Our review of the record shows that there is ample documentary support for the ALJ's finding. Moreover, as a general matter, we neither overturn credibility determinations made by a presiding officer nor reweigh evidence underlying his factual conclusions absent a showing of clear error. *See, e.g., Secrest v. Madda Trading Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,627 at 36,696 (CFTC Sept. 14, 1989). We decline to do so here.

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[16] *See* CFTC Interpretative Letter No. 91-9 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,189.

For these reasons, we find that from on or about September 1, 1983 until July 2, 1985, ECP had been operating as a CTA, as that term is defined in Section 1a(5) of the Act. For compensation or profit, ECP had engaged in the business of advising others, directly or through publications, writings or electronic media, as to the value of or the advisability of trading in commodity futures contracts or options. Without being registered in any capacity under the Act, ECP made use of the mails and other means or instrumentalities of interstate commerce in connection with its business as a CTA, in violation of Section 4m(1) of the Act. Accordingly, the ALJ's finding on Count Three of the First Complaint is affirmed.

> *Count IV: That PEC violated Section 4m of the Act from May 20, 1983 through on or about July l, 1985 by virtue of its role as parent company of Report and ECP such that accordingly, the activities described in Counts Two and Three above were authorized and conducted on behalf of PEC pursuant to Section 2(a)(1)(A)(iii) of the Act.*

Count Four of the First Complaint named PEC as a respondent on the theory that, PEC, as the parent company of Report Inc. and ECP, was liable under Section 2(a)(1)(A)(iii) of the Act as the principal for the violations of its agents, Report Inc. and ECP, in failing to register as CTAs. The "single enterprise" theory espoused by the ALJ appears to have been the basis on which the ALJ found PEC liable as a parent for the acts of its subsidiaries in failing to register. *In re Armstrong*, ¶ 24,545 at 36,345. We have already found that the ALJ erroneously found the respondents liable as "a single enterprise." *See* pp. 3-4 *supra.*

Nevertheless, we find that PEC is liable as a principal for the acts of its agents, ECP and Report Inc. under Section 2(a)(1)(A)(iii) of the Act. That section specifies that "the act, omission, or failure of any . . . person acting for any . . . corporation, . . . within the scope of his employment or office shall be deemed the act, omission or failure of such . . . corporation. . . ." In turn, Section la(16) also defines the word "person" to include "corporations." *See generally* Harry G. Henn & John R. Alexander, *Law of Corporations*, § 148 at p. 356 (3d Ed. 1983) ("[i]f corporateness is disregarded, parent and subsidiary assume a common identity under the alter ego theory. If corporateness is recognized, there may be a principal-agent relationship between parent and subsidiary"). Indeed, Congress, the courts and the Commission have uniformly held that Section 2(a)(1)(A)(iii) was intended to cover all forms of principal-agent relationship. *Reed v. Sage Group, Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,943 at 34,300 (CFTC Oct. 14, 1987). Under the clear wording of these provisions in Section 2(a)(1)(A)(iii), a parent corporation can be held liable as a principal for the acts of its subsidiary corporation as long as the facts establish agency, *i.e.*, a subsidiary acting for the parent within the scope of its employment or office.[17]

As a general rule, a corporation does not become an agent of another corporation merely because a majority of its voting shares is held by the other corporation. Restatement (Second) of

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[17] On appeal, respondents have not argued that either ECP or Report Inc. were acting outside the scope of their employment when they failed to register.

Agency § 14 M (1958). In appropriate circumstances, however, a parent corporation will be held liable for the acts of its subsidiary because the subsidiary's affairs have been so controlled as to render it merely an instrument or agent of its parent. *Berger v. Columbia Broadcasting System, Inc.*, 453 F.2d 991, 994 (2d Cir. 1972). Our review of the unusual facts established on this record discloses sufficient evidence of PEC's control over the conduct of ECP and Report Inc. to establish that these subsidiaries were acting as their parent's agent for purposes of Section 2(a)(1)(A)(iii). The record, for example, establishes that all the corporate respondents were small entities dominated by a single individual. Moreover, respondents PEC and Report shared the same checking account until at least August 1984. Tr. 2023. One of the employees who worked for PEC was paid by Report Inc. Subscribers to the *Armstrong Report* and newsline services were directed to send their subscription fees to PEC. Although most of the client managed account documents list ECP as the managing firm, PEC is named as the managing firm for one of the managed account clients. Div. Exs. 57-67. PEC solicited news subscriptions for Report Inc. The futures commission merchant carrying broker executing futures trades for the managed account clients initially paid respondent PEC, then later changed and paid respondent ECP. In their advertising, respondents PEC, Report Inc., and ECP promoted their CTA services without identifying individual units.

We find that the existence of all these factors establishes a principal-agent relation between PEC, as parent, and ECP and Report Inc., as agents. *See NLRB v. Deena Artware, Inc.*, 361 U.S. 398, 402-03 (1960) ("Yet as Mr. Justice Cardozo said in *Berkey v. Third Avenue R. Co.*, 244 N.Y. 84, 95, 155 N.E. 58, 61, 'Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice.' "). Accordingly, we affirm the ALJ's finding that PEC is liable as a principal under Section 2(a)(1)(A)(iii) of the Act for the acts of its agents, ECP and Report Inc.

> *Count Five: That Armstrong and ECP violated Commission regulation 4.31 by failing to deliver to each managed account client and each prospective client a Disclosure Document during the period from September 1, 1983 to at least August 2, 1984.*
>
> *Count Six: That PEC violated Commission regulation 4.31 during the period from September 1, 1983 to at least August 2, 1984 by virtue of its role as parent company of ECP such that the omissions or failures of ECP are also those of PEC pursuant to Section 2(a)(1)(A)(iii) of the Act.*

From September 1983 until August 1984, ECP agreed to direct the trading of commodity interest accounts for various clients. Div. Exs. 58-71. None of these clients was given a disclosure document at the time ECP accepted them as managed-account clients. ECP eventually prepared a disclosure document with an issue date of August 15, 1984. The 1984 disclosure document was filed with the Commission on September 25, 1984 and was distributed to seven of ECP's eight existing managed account clients. After distributing copies of its disclosure document on September 25, 1984, ECP accepted two more managed-account clients, but gave neither a copy of the 1984 disclosure document.

Count Five of the First Complaint alleges that, from on or about September 1, 1983, until at least August 2, 1984, Armstrong and ECP failed to provide prospective managed-account clients with a disclosure document, in violation of regulation 4.31(a). Count Six of the First Complaint charges that PEC is liable as a principal under Section 2(a)(1)(A)(iii) for ECP's violations. In the initial decision, the ALJ found that Armstrong, ECP, and PEC were required to deliver, and willfully failed to deliver, proper disclosure documents to prospective and existing managed account clients during the relevant period. *In re Armstrong*, ¶24,545 at 36,355. On appeal, respondents argue that they were not subject to the requirements of Regulation 4.31(a) because they were not registered or required to register under the Act.

Regulation 4.31(a) requires a CTA registered or required to be registered under the Act to deliver a disclosure document to a prospective client before or at the time the CTA solicits or enters into an agreement with such prospective client to guide the client's commodity interest trading. If the disclosure document is materially inaccurate or incomplete in any respect, the CTA must correct and distribute a correction to all existing clients, and to each previously solicited prospective client, prior to entering into an agreement to direct or guide such client's account. Regulation 4.31 specifies the information required to be contained in the disclosure document.

In view of our previous determination that Armstrong was not required to register as a CTA, we reverse the ALJ's determination that Armstrong is individually liable under Regulation 4.31(a) for failing to deliver the required disclosure document.

Turning to respondent ECP's liability, an examination of the record discloses that ECP failed to deliver to its managed account clients the disclosure document required by Regulation 4.31(a). For the reasons stated in the Initial Decision and in our discussion of Count III, *supra*, we already found that ECP was required to register under Section 4m of the Act. Since ECP was required to register under the Act, it was subject to the requirements of Regulation 4.31(a). By failing to deliver the disclosure documents, ECP violated Regulation 4.31(a). *See CFTC v. Ehrenberg*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,640 at 26,431 (E.D. Ill. Dec. 15, 1982). As explained above, there is sufficient evidence of a principal-agent relationship to find PEC liable as a parent for the violations of its subsidiaries under Section 2(a)(1)(A)(iii) of the Act. Thus, we affirm the ALJ's finding that PEC is liable under Section 2(a)(1)(A)(iii) of the Act for ECP's violation of Regulation 4.31(a).

Count Seven: That Armstrong, ECP and Report violated Regulation 4.32 by failing to keep books and records since May 30, 1984.

Count Eight: That PEC has violated Commission regulation 4.32 since May 30, 1984 by virtue of its role as parent company of ECP and Report such that the omissions or failures of the subsidiaries are those of PEC pursuant to Section 2(a)(1)(A)(iii) of the Act.

Count Seven of the First Complaint alleges that, in violation of Regulation 4.32, Report Inc., ECP, and Armstrong failed to maintain certain books and records which each CTA registered or required to register under the Act must make and keep as a matter of law. Pursuant to Section 2(a)(1)(A)(iii) of the Act, Count Eight charges PEC with liability for Report Inc. and ECP's violations of Regulation 4.32.

On May 24, 1984, the Division issued a subpoena to the custodian of records for PEC requiring the production of certain books and records. Tr. 336-337, 1553-1555; Div. Ex. 1. This subpoena was received by PEC on May 30, 1984. In the subpoena, the Division defined "PEC" to include "any and all of its principals, directors, officers, employees, agents, independent contractors, affiliates, assigns, predecessors, successors and subsidiaries." Div. Ex. 1. Respondents have never argued that PEC lacked "possession, custody or control" of the documents required to be kept by those of its subsidiaries who were required to be registered as CTAs. Although PEC produced some of the books and records required by the subpoena, PEC failed to produce (a) any of the powers of attorney which had been executed by ECP's managed account clients; (b) any trading records for the managed account of John DeBlois; (c) the original or copies of any correspondence between Armstrong and DeBlois; (d) any of the advertisements printed in *Barron's* and *Futures* magazine; and (e) the "How to Use" Manual which had been prepared and distributed to subscribers in 1983.

In the Initial Decision, the ALJ found that the respondents had failed to keep powers of attorney authorizations, Mr. DeBlois' account transaction statements, advertisements, and the manual "How to Use the Armstrong Report" in violation of the Commission's record keeping requirements. *In re Armstrong*, ¶ 24,545 at 36,355. On appeal, respondents argue that Regulation 4.32 is inapplicable to them because they were not registered or required to be registered under the Act.

Regulation 4.32 requires each CTA registered or required to be registered under the Act to make and keep certain records in an accurate, current and orderly manner at its main business office and in accordance with the provisions of Regulation 1.31. Among such records are various documents concerning the CTA's existing or prospective clients or subscribers. Pursuant to Regulation 1.31, each record must be retained by the CTA for five years after its date of issuance and must be readily accessible for the first two years of the five-year retention period.

For the reasons discussed during our analysis of Counts Five and Six of the First Complaint, we reverse the ALJ's finding that Armstrong individually is liable for violating Regulation 4.32. On the other hand, we sustain the ALJ's finding that ECP and Report Inc. are liable under Regulation 4.32 for failing to comply with the Commission's record keeping requirement. *In re Polyaxon Capital, Inc.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,192 at 32,509 (CFTC Aug. 7, 1986). We also affirm the ALJ's finding that PEC is liable under Section 2(a)(1)(A)(iii) as principal for the acts of ECP and Report Inc. in failing to comply with the Commission's record keeping requirement.[18]

SANCTIONS

As a result of our determination to reverse the Initial Decision and dismiss the First Complaint as to Armstrong individually (Counts One, Five and Seven), we have determined to modify the sanctions to reflect the elimination of these liability findings. The ALJ imposed a civil monetary penalty on Armstrong of $24,000. This penalty was predicated on his liability under both the First Complaint and the Second Complaint. Because we have reversed the liability determinations against Armstrong individually under the First Complaint, we believe the civil monetary penalty imposed by the ALJ is no longer appropriate.[19] Consequently, we reduce the civil monetary penalty assessed against Armstrong from $24,000 to $12,000.

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[18] We have reviewed respondents' arguments concerning their affirmative defense of reliance upon the advice of counsel. In the Initial Decision, the ALJ found that the evidence fails to demonstrate that respondents fully disclosed all relevant information to their counsel regarding their business activities and thus failed to prove the defense of reliance upon counsel. *In re Armstrong*, 24,454 at 36,360 and 36,364. We concur.

We also vacate the 12-month trading prohibition against Armstrong. On this record, we find that there is no nexus between his violations and the integrity of the futures markets. *See In re Incomco, Inc.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,198 at 38,537-38 (CFTC Dec. 30, 1991). Although we sustained all of the ALJ's liability findings against PEC, Report Inc., and ECP, it would be inconsistent to maintain this sanction against those respondents when we have set aside the trading ban against Armstrong. Like Armstrong, there is no nexus between their violations and the integrity of the futures markets. For this reason, we vacate the trading ban against each respondent.

We also reverse the ALJ's imposition of registration revocations on the respondents. While we find that the respondents' violations were sufficiently serious to warrant the imposition of registration revocations, we decline to do so here because the registrations of Armstrong, Report Inc., and ECP have lapsed. In this case, the respondents' violations of Section 4o and 4b(i), and Regulation 4.41(a) involved fraud or wilfully inducing fraud. Thus, the ALJ's findings are a statutory disqualification from registration pursuant to Section 8a(2)(E) of the Act and raise a presumption that respondents are unfit for continued registration. *See In re Antonacci*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,835 at 36,930 (CFTC Apr. 19, 1990). According to current registration records, however, respondent Armstrong, ECP, and Report Inc.'s registrations terminated while this proceeding was pending.[20] Under Section 8a(2)(E), should any of the respondents apply for registration in the future, the findings in this case will raise a presumption that the respondent is unfit for registration for ten years. Registration will only be granted if that respondent rebuts this presumption with a clear and compelling showing that registration will not pose a substantial risk to the public. *See In re Horn*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,836 (CFTC Apr. 18, 1990). In these circumstances, revocation of Armstrong, ECP, and Report Inc.'s lapsed registrations is not a necessary step. *See In re Newman*, CFTC Docket No. 88-19 (CFTC Aug. 6, 1992); *In re Rosenthal & Co.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,221 at 29,189-90 (CFTC June 6, 1984).

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[19] In appropriate circumstances, the Commission may retain the same monetary penalty despite a reduction in the number of violations found by the ALJ. *See In re Apache Trading Corp.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,251 at 38,796 (CFTC Mar. 11, 1992). Nevertheless, we exercise our discretion here to reduce the civil monetary penalty to reflect the elimination of some of the bases for liability.

We find the imposition of the cease and desist orders to be appropriate to deter future misconduct. Moreover, we note that respondents' brief on appeal solely raised the general issue of the propriety of the sanctions, arguing that there was no basis for the sanctions imposed. Under these circumstances, we affirm the ALJ's decision to impose cease and desist orders against the respondents.

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[20] Respondent PEC was never registered with the Commission in any capacity.

* * * * * *

Accordingly, we reverse the ALJ's liability findings against Armstrong under the First Complaint. As noted above, we have reduced the civil monetary penalty imposed on Armstrong from $24,000 to $12,000 to reflect the elimination of some of the bases of his liability. We have also reversed the ALJ's imposition of registration revocations and the 12-month trading ban. In all other respects, we deny the appeal. The sanctions are effective within 30 days from the date of service of this order.[21]

IT IS SO ORDERED.

By the Commission (Chairman GRAMM and Commissioners WEST, ALBRECHT, BAIR, and DIAL).

s/ Jean A. Webb
Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission

Dated: February 8, 1993

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[21] A motion to stay the effect of these sanctions pending reconsideration by the Commission or review by a court must be filed and served within 15 days of the date this order is served. *Compare* Commission Regulation 10.106.

APPENDIX F — INITIAL DECISION DATED FEBRUARY 28, 1990

In the Matter of Armstrong, et al.

Commodity Futures Trading Commission.

No. 85-47 and No. 87-10.

February 28, 1990.

Initial Decision in full text.

* * *

Stephen F. Mihans, Esquire, and *Janet Kosman-Rose, Esquire*, Eastern Regional Office, Commodity Futures Trading Commission, New York, New York, for the Division of Enforcement.

Christopher Lovell, Esquire, New York, New York, for the respondents.

Opinion of DUNCAN, Administrative Law Judge.

Statement of the Case

This is an enforcement proceeding upon consolidated cases arising under the Commodity Exchange Act, as amended, 7 U.S.C. §§ 1 *et seq.* ("CEAct") instituted by complaints issued by the Commodity Futures Trading Commission. On October 30, 1989, after notice and hearing sessions, an Initial Decision and Order ("Initial Decision") as to liability and providing specified sanctions and provisional civil penalty assessments was issued. The Initial Decision and Order determined that Respondents had engaged in violations of Sections 4b(A), 4m and 4*o*(1) of the CEAct, 7 U.S.C. §§ 6b(A), 6m and 6*o*(1). Certain specific sanctions were established and also a tentative civil penalty in the total amount of $50,000.00 was proposed. A hearing was scheduled for December 18, 1989, to receive evidence and any objection. At the hearing the Division of Enforcement ("Division") appeared and offered documents and adduced testimony. Respondents did not appear at the December 18, 1989 hearing and no representative for the Respondents appeared (Tr. 2136).[1] On January 25, 1990, the Division filed proposed findings of fact, conclusions of law and supporting brief. On February 22, 1990, Respondents filed an opposition to sanctions. On February 26, 1990, the Division of Enforcement filed a memorandum in response. The submissions by the parties are accepted for filing. Based upon the entire record, I make the following findings of fact, conclusions of law and order:

Findings of Fact and Conclusions of Law

1. In the October 30, 1989, Initial Decision and Order, findings of fact and conclusions of law were stated. Liability was determined as to Respondents' violations of the CEAct. It was found and concluded that Respondents, or some of them, willfully violated Sections 4b(A), 4m and 4*o*(1) of the CEAct, 7 U.S.C. § 6b(A), 6m and 6*o*(1) and the Commission's Regulations, by engaging in the following outlawed acts and practices between March 1, 1983 and July 1, 1985: (1) transacting business as commodity trading advisors while not registered as required, (2) failing to deliver required disclosure

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[1] The record references are to the transcript of hearing dated December 18, 1989. References to the October 30, 1989, Initial Decision and Order are to "I.D." References to Division of Enforcement exhibits are shown as "DE Ex."

documents, (3) failing to keep required records, (4) receiving undisclosed commission rebates, (5) failing to correct the 1984 disclosure document, (6) engaging in false and misleading advertisements, and (7) representing hypothetical trading results without including the required caution (see I.D. ¶¶ 29, 43, 48, 61, 68, 79, 82). The findings and conclusions in the Initial Decision, insofar as violations of the CEAct and the Commission's Regulations by Respondents were determined, are adopted and incorporated here by reference as if fully set forth herein.

2. In the Initial Decision of October 30, 1989, it was found and concluded that the violations warranted, because of their nature and seriousness, the imposition of specified sanctions against Respondents. These sanctions were, in part, a revocation of Respondents' registrations, a cease and desist order prohibiting repetition of the violations, and a prohibition against trading for a twelve (12) month period.

3. In the Initial Decision of October 30, 1989, each of the sanctions was listed, the evidence of record carefully sifted and the relationships between the sanctions and the proven violations were discussed. The object with respect to sanctions is to secure corrective action and achieve the intent of the CEAct. The violations were committed with the participation and full knowledge by the Respondents of their character and importance.

4. For the purposes of this Initial Decision and Order, *sub judice*, Respondents' challenged activities have been re-examined, particularly the gravity of the violations *vis-a-vis*, the amount of the civil penalties proposed as appropriate. All of the testimony and exhibits including those previously adduced as well as those received at the December 18, 1989, hearing session, have been evaluated. The findings and conclusions contained in

the Initial Decision of October 30, 1989, are determined to be proper and are re-confirmed and adopted herein.

5. A detailed and comprehensive search of the record does not reveal any mitigating or extenuating facts that countermand the violations by Respondents or militate against the importance of the actions. Respondents have not demonstrated any rehabilitation since the violations were found to have occurred. The findings and conclusions that Respondents are unfit for registration under the CEAct, determined in the Initial Decision and Order of October 30, 1989, are hereby reaffirmed.

6. In the Initial Decision of October 30, 1989, it was provided that the tentative or provisional amounts of civil penalties should be the following (I.D. p. 55):

— Respondent Armstrong	$24,000
— Respondent EPC	$12,000
— Respondent PEC	$10,000
— Respondent Report	$4,000

It was further provided in the October 30, 1989 Initial Decision that *(Ibid.)*:

> *NOTICE* is hereby given of a *HEARING* commencing at 10:00 a.m. on December 18, 1989 at a courtroom to be designated in New York City, New York, to receive evidence and any objections as to whether there should be any civil penalty or amount thereof. Any party intending to participate in the

> scheduled hearing is directed file and serve by no later than December 5, 1989, a *STATEMENT* of such intent and to indicate therein matters intended to be presented by the party together with a brief statement of the evidence proposed to be offered. If no such *STATEMENT* is filed and served by a party within the time allowed the party shall be deemed to have waived participation in any further proceedings prior to the issuance of a final Order herein.

7. Within the time allowed, the Division of Enforcement filed its statement that it intended to participate at the December 18, 1989 hearing. On December 1, 1989 and December 13, 1989, Respondents filed statements and an amended statement, respectively, saying that they did not intend to participate in the December 18, 1989 hearing. Respondents' assertion in their opposition to sanctions (pp. 1-2), that they had no notice concerning the December 18, 1989 hearing session is rejected as incredible and contradicted by their responses. Upon application by the Division, a subpoena *duces tecum* (DE Ex. NW 1) was issued to Respondent Armstrong requiring that he appear at the hearing and testify concerning the Respondents and bring documents concerning Respondents to the December 18, 1989 hearing session. No compliance with the subpoena was received (Tr. 2139).

8. At the December 18, 1989 hearing session, evidence was offered and received as to Respondents' current business activities, income and assets. A former associate of Respondent, Armstrong, Bruce Winans (Tr. 2143-2144), testified that Respondent Armstrong had informed him in November 1989, that Respondent Armstrong was conducting business operations

in Australia, Far East and Vancouver (Tr. 2143). Respondent Armstrong advised Mr. Winans that he was conducting seminars and receiving fees in the amount of $1,000 per person (Tr. 2144-2145).

9. Evidence was received at the hearing that Princeton Economic International, LTD, was a successor firm to Respondent Princeton Economic Consultants Inc. (DE Ex. 16 NW p. 1; DE Ex. 17 NW p. 6). As found and concluded in the Initial Decision, Respondent Princeton Economic Consultants, Inc. is sole owner and a principal of Respondent Economic Consultants of Princeton, Inc. and Respondent Armstrong Report, Inc.

10. Based upon the submissions of documents by the parties, the evidence of record adduced at the December 18, 1989 hearing, the failure by Respondents to appear at the December 18, 1989 hearing and the failure of Respondent Armstrong to appear or produce documents in response to the subpoena issued to him, it is concluded that Respondents have waived any objection as to the amount of civil penalties to be assessed against them. I find and conclude that all of the sanctions set forth in the Initial Decision and Order of October 30, 1989, including a civil penalty in the total amount of $50,000, which appears to be collectable, are necessary and reasonably related to the proven violations by Respondents and should be imposed.

Based upon the foregoing Findings of Fact and Conclusions of Law, I issue the following:

ORDER

I. The findings of fact and conclusions of law in the Initial Decision and Order of October 30, 1989, in this case, insofar as violations of the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.*, and the Commission's Regulations by Respondents were determined, are adopted and incorporated here by reference as if fully set forth herein. The provision in the October 30, 1989 Decision and Order which held in abeyance, a part of that Order is VACATED.

II. The allegations of the complaints are *SUSTAINED*.

III. Respondents' registrations under the CEAct are hereby REVOKED.

IV. Respondents are directed to CEASE AND DESIST from engaging in the violations of the type determined here of the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.*, and the Commission's Regulations.

V. Respondents are prohibited from trading on or subject to the rules of any contract market for a period of twelve (12) months from the date this Order becomes final. All contract markets shall refuse all trading privileges to Respondents until the expiration of the twelve (12) month period. Such prohibition and refusal shall apply to all trading done and positions held directly by Respondents, either for their own individual accounts or as the agent or representative of any other persons or firm, and to all trading done and positions held indirectly through persons or firms owned or controlled by Respondents or otherwise.

APPENDIX G — INITIAL DECISION DATED OCTOBER 30, 1989

In the Matter of Armstrong, et al.

Commodity Futures Trading Commission.

No. 85-47 and 87-10
October 30, 1989

Initial Decision in full text.

* * *

Herbert Sue, Esq., and *Stephen F. Mihans, Esq.*, Eastern Regional Office, Commodity Futures Trading Commission, New York, New York, for the Division of Enforcement.

Christopher Lovell, Esq., New York, New York for the respondents.

Opinion of DUNCAN, Administrative Law Judge.

STATEMENT OF THE CASE

This is an enforcement case arising upon consolidated administrative complaints issued under the Commodity Exchange Act ("CEAct"). The first complaint was issued on September 30, 1985, in CFTC Docket No. 85-47. It asserts that facts exist proving that Respondents violated the CEAct by conducting a commodity trading advisor business without being registered (counts I, II, III and IV), failing to deliver proper disclosure documents (counts V and VI) and failing to maintain proper records (counts VII and VIII).

Appendix G

The second complaint, as amended, in CFTC Docket No. 87-10[1] alleges that the individual Respondent and Respondent Economic Consultants of Princeton, Inc., violated provisions of the CEAct by maintaining, undisclosed to customers, a commission-sharing arrangement which constituted cheating, fraud and deceit under the CEAct (counts I and II), and by failing timely to correct information used in disclosure documents (count III). The second complaint further asserts that the individual Respondent and Respondent Princeton Economic consultants, Inc., violated the Commission's Regulations by engaging in false, deceptive and misleading advertising (count IV), and by failing to include a required statement with the presentation of hypothetical performance claims (count V).

In their answer filed to the first complaint No. 85-47 Respondents admit certain statement in the first complaint, deny other assertions and deny any violations. In their answer eleven affirmative defenses are asserted: *First,* there is a failure to state a claim upon which relief can be granted; *Second,* there is a lack of jurisdiction; *Third,* sections of the CEAct and the regulations are unconstitutional under the First Amendment; *Fourth,* the CEAct and the regulations have been applied without due process; *Fifth,* sections of the CEAct and provisions of the regulations are unconstitutional as a deprivation of equal protection of the laws; *Sixth,* prosecutorial misconduct has occurred; *Seventh,* there is no basis for any sanctions against Respondents; *Eighth,* the proceeding was instituted with an improper motive by the Commission; *Ninth,* there was a failure to give Respondents notice and an opportunity for compliance; *Tenth,* the Commission has lost registration records and is estopped from maintaining this case against Respondents; and

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[1] The amended complaint in CFTC Docket Number 87-10 does not include Armstrong Report, Inc., as a Respondent.

Eleventh, all alleged violations are insignificant and have been cured.

In their amended answer filed to the second complaint No. 87-10, Respondents admit certain statements in the complaint as amended, deny other assertions and deny any violations. In their amended answer three affirmative defenses and four subsidiary matters are asserted: *First,* there is a failure to state a violation of law for which relief may be granted; *Second,* going forward with the proceeding is contrary to the public interest; and *Third,* they at no time held than fifteen powers of attorney. As subsidiary matters it is claimed that Respondents are entitled to exculpatory information, relied upon attorney's advice, and attempted to act in good faith and that a ruling in conflict with such claims would violate the Constitution and applicable statutes and regulations.

By memorandum and order dated November 21, 1985, Repondents' motion in No. 85-47 for a more definite statement of the allegations in the complaint was denied. *In the Matter of Armstrong, et al.,* Comm. Fut. L. Rep. (CCH), ¶ 22,835 (Memorandum and Order 1985) p. 31,456. On July 16, 1987, upon motion by the Division of Enforcement ("Division") and opposition thereto the two proceedings commenced by the separate complaints were consolidated. By an Order dated December 17, 1987, Respondents' affirmative defense, that in maintaining the proceeding, No. 87-10, the Commission was not acting in the public interest, was determined to be a claim that was foreclosed to Respondents and the Division's motion to strike as to this affirmative defense was granted.

Hearings were held in segments during July, September and October 1987 in Washington, D.C. and during 1988 in New York. The transcript consists of fourteen volumes and a total of 2133 pages, numerous exhibits were received in the record.

Appendix G

ISSUES

The complaints, answers and the matters of record present the following issues:

> I. Whether Respondents engaged in outlawed acts and practices between March 1, 1983 and July 1, 1985, by, (1) transacting business as commodity trading advisors while not registered as required, (2) failing to deliver required disclosure documents, (3) failing to keep required records, (4) receiving undisclosed commission rebates, (5) failing to correct the 1984 disclosure document, (6) engaging in false and misleading advertisements and, (7) representing hypothetical trading results without including the required caution.
>
> II. Whether, if it is determined that the facts and the violations alleged have been established, administrative sanctions should be provided.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. Respondent Martin A. Armstrong Jr., in his business career has been interested in providing market analysis and market advice for financial gain. He was born on November 1, 1949 (Tr. 1011).[2] At age 13 he had his first employment at a coin

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[2] The abridgments used to designate documents in the record are the following: complaint issued 9/30/85 ("I Comp."); complaint issued 6/23/87 ("II

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and stamp dealership. He conducted transactions in gold coins from foreign countries and other collectable coins and philatelic materials (Tr. 1013). When he was 15 years old his net worth was more than one million dollars as a result of his business transactions (Tr. 1017). He continued his coin and stamp employment and progressed to manager of the establishment. (Tr. 1013). In 1970 Respondent Armstrong became a partner with Norman Lavison (Tr. 1023, 1161). Their store was Collectors Gallery. In 1976 be bought Mr. Lavinson's interest. The firm did 15 to 20 million per year in gold coins, bullion and scrap gold sales in 1980-1983 (Tr. 1025, 1036). Respondent Armstrong became interested in observing commodity prices, particularly market price trends for precious metals (Tr. 1029). He began to publish predictions and recommendations for others in 1973, using a teletype system to transmit highs, lows and other price information (Tr. 1031-1035). This was "kind [of] like a hobby" (Tr. 1042). In 1982-1983 expenses and competition in the coin and stamp business increased and profits declined. The store was closed in 1985 (Tr. 1037-1038). The cash gold business also declined and became an unprofitable side-line in 1982-1983 (Tr. 1038-1040, 1180-1181, 1975, 2079-2080). In 1983 or prior thereto Respondent Armstrong determined to accept

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Comp."); answer filed 12/10/85 ("I Ans."); answer filed 8/12/87 ("II Ans."); Division of Enforcement's Request for Admissions dated 6/20/86 ("Req. Adm."); Respondents' Response to the request for admissions dated 7/31/86 ("Resp. Response"); transcript of testimony ("Tr. __"); Division of Enforcement's exhibits ("DE Ex."); Respondents' exhibits ("Resp. Ex."); Division of Enforcement's post-hearing Memorandum ("D.E. Mem."); Respondents' post-hearing memorandum of law ("Resp. Mem."); Respondents' post-hearing proposed findings of fact and conclusion of law ("Resp. Prop. Fndgs. & Con."). Usually the page number is given to facilitate location of the item indicated.

subscriptions from members of the public for newsletters and publications (Tr. 1042). In 1983 the three Respondent corporations, Princeton Economic Consultants, Inc., Economic Consultants of Princeton, Inc. and Armstrong Report, Inc. were formed (Tr. 1045-1046). In March 1983 Respondent Armstrong began issuing publications (Tr. 1050-1064). "We were giving investment advice" (Tr. 1065). It was stipulated by the parties that Respondent Armstrong became registered as a commodity trading advisor on July 2, 1985 (Tr. 1103, 1767-1768). He was also registered as a commodity pool operator. He never used the registration or operated as a commodity pool operator (Tr. 1540). Currently Respondent Armstrong is registered as an associated person of Manning Stotler Commodities, Inc., a futures commission merchant (Tr. 1540). Respondent Armstrong is a principal, sole stockholder, president and director of Princeton Economic consultants, Inc. He is president and director of Economic Consultants of Princeton, Inc. and Armstrong Report, Inc. (I Comp. 1-2; I Ans. 1; Tr. 271).

2. Respondent Princeton Economic Consultant, Inc. ("PEC") is a holding company (Tr. 1040). Through this firm Respondent Armstrong provided personal consultation and seminar programs (Tr. 176, 1764). Respondent PEC is not registered with the CFTCommission in any capacity. Respondent PEC is a principal and sole owner of Respondent Economic Consultants of Princeton, Inc. and Respondent Armstrong Report, Inc. (I Comp. 2; Ans. 1).

3. Respondent Economic Consultants of Princeton, Inc. ("ECP") is a subsidiary of PEC (Tr. 1779; DE Ex. 41, p.5) and manages client investment money (Tr. 176, 1140). Respondent ECP was registered from July 2, 1985 through July 31, 1986 as a commodity trading advisor (Tr. 996; DE Ex. 14). Respondent

Armstrong is president of Respondent ECP (Tr. 271) and he controls the firm (Tr. 620). Respondent ECP is no longer registered with the CFTCommission and has ceased business (Tr. 1540).

4. Respondent Armstrong Report, Inc. ("Report") is a subsidiary of PEC (Tr. 1779) and was established by Respondent Armstrong to issue written reports to clients and to disseminate the telephone and telex newsline messages to clients (Tr. 1962-1983). Report was registered as a commodity trading advisor from July 2, 1985 through July 31, 1986 (DE Ex. 14) and is no longer registered with the CFTCommission (Tr. 1540).

5. During March 1, 1983 - July 2, 1985 the individual Respondent Armstrong; during May 20, 1983 - July 1, 1985 the corporate Respondent Report; during September 1, 1983 - July 1, 1985 the corporate Respondent ECP and during May 20, 1983 - July 1, 1985 the corporate Respondent PEC transacted business with clients or potential clients. They provided analysis on trading commodity futures and commodity options trading contracts on contract markets (I Comp. 4-5; I Ans. 1). The questions presented herein center on an evaluation of the details pertaining to the Respondents' clients and potential clients and the character of their client services and their offers of such services.

> I. Respondents furnished personalized commodity futures trading and advice and held themselves out as commodity trading advisors offering such advice without having registered with the CFTCommission in violation of Section 4m of the CEAct, 7 U.S.C. § 6m, and engaged in other acts and practices in violation of the CEAct and Commission Regulations.

6. In the CEAct a "commodity trading advisor" is defined for the purpose of the CEAct as any (Sec. 2(a)(1)(A)):

> person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market, any commodity option authorized under section 4c, or any leverage transaction authorized under section 19, or who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the foregoing; but such term does not include . . . (iv) the publisher or producer of any print of electronic data of general and regular dissemination including its employees . . . provided, that the furnishing of such services by the persons is solely incidental to the conduct of their business or profession. . . . [Certain additional exclusions are stated and the Commission is authorized to include by rule or regulation other persons engaged in designated activities within the definition].

With regard to the required registration of commodity trading advisors the CEAct provides (Sec. 4m(1)):

> It shall be unlawful for any commodity

> trading advisor or commodity pool operator, unless registered under this Act, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor or commodity pool operator: *Provided,* That the provisions of this section shall not apply to any commodity trading advisor who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading advisor. . . . [Certain commodity trading advisors are exempted from the registration requirement.]

> A. The corporate Respondents and the individual Respondent acted together to the advantage and benefit of each other as a single enterprise under the CEAct in the operation of their commodity futures trading advice business.

7. It is contended by Respondents that the activities of the individual Respondent and the corporate Respondents must be evaluated in isolation from each other. (Resp. Mem. 3, 7, 8) Respondents say ". . . No case for agency or corporate veil piercing has been made out . . ." (Resp. Mem. 8). The record of Respondents' conduct affords no basis to compartmentalize the group or insulate them from each other. The individual, Respondent Armstrong, controlled and dominated all aspects of the corporate Respondents' commodity futures trading business and co-mingled the activities of the firms. Respondents

described themselves as a "group" (DE. Ex. 41 p.5) enterprise. The activities and functions of the Respondents on this issue were merged and inseparable.

8. As determined, *supra*, p. 5, Respondents PEC, ECP and Report were established in May 1983 (Tr. 1762). Respondent PEC was regarded as the holding company and was solely owned by Respondent Armstrong (Tr. 840-841). In turn, Respondent PEC was the owner and sole stockholder of Respondents EPC and Report (Tr. 1779). Initially, when the firms were set-up, there was no organizational or shareholders meeting (Tr. 1787-1788). The firms have no officers except Respondent Armstrong who is president and sole director of each firm (Tr. 270-271, 626, 847, 1780-1784). As of 1984 Respondent ECP was not capitalized (Tr. 1786), and had no bank checking account (Tr. 1985-1786).

9. No sharp or bright lines of corporate separation were established or maintained. The corporate names were mingled and used interchangeably. Areas of operations were transferred whenever it appeared to suit Respondents' convenience. The Respondents shared the same offices, mailing address and the same work force (Tr. 872, 1773, 1784). An employee who nominally worked for Respondent PEC was paid by Respondent Report (Tr. 175-176) with her salary amount fixed and controlled by Respondent Armstrong (Tr. 177). Most of the client managed account documents have Respondent ECP listed as the managing firm (See DE. Ex. 57-67). On DE Ex. 68 Respondent PEC is named as the managing firm. Repondents PEC and Report shared the same checking account until at least August 1984 (Tr. 2023). The future commission merchant carrying broker executing futures trades for Respondents managed account clients in making commission-sharing payments to Respondents initially payed Respondent PEC, but then changed and made such

payments to Respondent ECP (Tr. 792-798, 802-803; DE. Ex. 125). In their advertising Respondents promoted the CTA services of the Respondents without identifying individual units. For example, in the June 20, 1983 advertisement in *Barron's* Respondent Report represented DE. Ex. 19):

> The Armstrong Report is proud of the fact that we are far more than just a newsletter. We provide economic consultation to individuals, banks corporations, metal dealers jewelry manufacturers, photo industry, and even governments. Our rates may be the highest in the world, but our clients testify that we are also the best.
>
> * * * *
>
> We offer personal consultation that gets you immediate access to analysis that is billed to your account for the time that you use only on a per minute basis. We offer seminars for a weekend at the cost of $500.

Respondent EPC was the corporation to provide personal consultation and seminar programs (Tr. 176, 1764). Other examples of the commingling of functions and failure to keep separate the corporate activities are shown in the record (See Tr. 1789-1790; DE Exs. 17, 18 p.2, 20-30).

10. Respondent Armstrong had and exercised full domination and control over all operations of the three corporate Respondents. Respondent Armstrong was in sole control of the corporate Respondents (Tr. 613, 719, 840). At the time relevant

here he was sole shareholder of Respondent PEC which was sole shareholder of Respondents ECP and Report (Tr. 1764-1781). He was president, sole director and only officer of each of the three firms (1769-1772, 1782-1783). Respondent Armstrong hired and trained employees for the corporate Respondents (Tr. 274) and established the pay rates (Tr. 177). He wrote the reports issued by the corporate Respondents (Tr. 178, 453) gave personal consultations (Tr. 181, 1297), prepared the market analysis (Tr. 192), conducted the seminars (Tr. 247, 273), prepared the advertisements (Tr. 221), and made the trading decisions in client managed accounts (Tr. 626, 723, 1297). He ran all the companies (Tr. 271-272) and regarded the corporate Respondents' files as his own (Tr. 1238). I find and conclude that Respondents acted for each other and represented each other. Respondents disregarded any nominal business separateness and conducted their futures trading business as a single enterprise.

11. Section 2(a)(1) of the CEAct, 7 U.S.C. § 4, provides, for purposes of the CEAct, that:

> * * * [T]he act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person.

This broadly expressed provision in the CEAct is not confined in its scope by common law and was intended by Congress, the

Commission has held, *Bogard v. Abraham-Rietz & Co.*, CFTC Docket No. R 77-315, Comm. Fut. L. Rep. (CCH), ¶22,273 (July 5, 1984, p. 29,393 fn. 13, "to cover all principal-agent relationships." In the circumstances here the provision for derivative liability is directly applicable. See *Irving Weis & Co. v. Brannan*, 171 F.2d 232, 235 (2d Cir. 1948) (No question as to any lack of proof of knowledge or participation by the registered firm can arise "since the Act is specific in providing * * *" for imputed liability for violations by those acting for the firm). See also *Kessenich v. Rosenthal & Company*, CFTC Docket No. R 77-276, Comm. Fut. L. Rep. (CCH), ¶21,181 (March 24, 1981), p. 24,866 fn. 15, *appeal dismissed, sub nom., Kessenich v. Commodity Futures Trading Commission*, 684 F.2d 88 (D.C. Cir. 1982). The actions by Respondent Armstrong are imputed to the corporate Respondents making them as well as Respondent Armstrong responsible for the violations. In like manner, Armstrong on the basis of his domination, direct control, receipt of benefits, and participation in the activities of the corporate Respondents is deemed responsible as the alter ego for the violations by the corporate Respondents. See Section 13(a) of the CEAct, 7 U.S.C. § 13c(a), which provides liability for violation committed by means of an intermediary. The "corporate entity may be disregarded when failure to do so would enable the corporate device to be used to circumvent a statute." *Alabama Power Co. v. Mcninch*, 94 F.2d 601, 618 (D.C. Cir. 1937); *Corn Products Refining Co. v. Benson*, 232 F.2d 554, 565 (2d Cir. 1956) (A case applying the provisions of the Commodity Exchange Act). See also, *Electric Bond & Share Co. v. Securities and Exchange Comm.*, 303 U.S. 419, 440 (1938); *Mansfield Journal Co. v. Federal Commun. Com'n.*, 180 F.2d 28, 37 (D.C. Cir. 1950). "To carry out statutory objectives, it is frequently necessary to seek out and give weight to the identity and characteristics of the controlling officers and stockholders of a corporation." *Mansfield Journal Co. v. Federal Commun. Com'n. supra.* In "determining liability to conform to a statutory standard of conduct, courts are practical and deal with realities; they 'look through form to substance and examine the entire transaction'; they 'pierce the corporate veil' to determine where the moving force actually lies. Corporate entity is disregarded where not to do so will defeat public convenience, work a fraud or justify a wrong." *Great Northern Co-op. Assn'n. v. Bowles,* 146 F.2d 269, 271 (Emer. Ct. App. 1944). The corporate entity has been disregarded in numerous circumstances to prevent fraud, injustice, or evasion of responsibilities. See e.g., *McCaskill Co. v. United States,* 216 U.S. 504, 515 (1910); *Hollander v. Henry,* 186 F.2d 582, 584-586 (2d Cir. 1951), *certiorari denied,* 341 U.S. 949 (1951); *Quinn v. Butz,* 510 F.2d 743, 757-759 (D.C. Cir. 1975); *United States v. Normandy House Nursing Home, Inc.,* 428 F. Supp. 421, 424-425 (D.C. Mass. 1977); *S.E.C. v. Elmas Trading Corp.,* 620 F. Supp. 231, 233-234 (D.C. Nev. 1985). I find and conclude that Respondent Armstrong as well as the other Respondents are responsible as a single enterprise, under the CEAct for the failure to register found herein.

> B. Respondents transacted and offered to transact business directly — on a person to person basis — and by publications and other services as commodity trading advisors.

12. The first complaint (CFTC Docket No. 85-47), counts 1-4, alleges, in part, that Respondent Armstrong between March 1, 1983 and July 1, 1985 for compensation or profit engaged in the business of advising others "both directly and through publications, writings or electronic media" as to the value or advisability of trading commodity futures contracts and between

March 20, 1984 and July 1, 1985 commodity options (I Comp. 11). The corporate Respondents are also alleged to have acted as commodity trading advisors. By their answer, Respondents have denied these allegations (I Ans. 2).

13. Respondents' activities are directly apprehended by the words in the definition of a CTA in the statute. The following CTA services were provided by Respondent Armstrong through the three corporate Respondents:

> *Managed accounts* were provided by Respondent Armstrong through Respondent ECP (Tr. 176, 620-621, 626-627, 1764). The managed accounts program was for commodity futures trading and options on behalf of clients by Respondent Armstrong (Tr. 4233). A client by executing a power of attorney to Respondent Armstrong or one of his firms authorized trades in the client's account (Tr. 612-613). The managed account clients were charged fees by Respondents consisting of a 6-percent management fee and a 20-percent portion of any profits (Tr. 637).
>
> *Personal consultations* were provided by Respondent Armstrong through Respondent PEC or Respondent EPC (Tr. 176, 1764; DE Ex. 51). Individuals called Respondent Armstrong for personal advice concerning trading commodity futures and options (Tr. 181; DE Ex. 51). Such clients would receive "trading advice at the time or at the moment"

(Tr. 183) concerning gold, silver, and platinum commodity futures contracts and option contracts (Tr. 185). Also covered were the five futures contracts currencies on the International Money Market exchange (Tr. 185-186). Consultation fees ranged from $1,500.00 per hour (Respondent PEC advertisement in *Barron's* March 24, 1983; DE Ex. 17) to $4,000.00 per hour (Tr. 83, 1810; DE Ex. 42, p. 43).

Armstrong Reports were provided by Respondent Armstrong through Respondents PEC and Report (Tr. 1763). These written reports were published either monthly or every two months (Tr. 178). In 1983 there were approximately 500 subscribers (Tr. 179). In 1984 the number of subscribers increased to approximately 1,000 subscribers (Tr. 179). Respondent Armstrong as a regular procedure wrote the Armstrong Reports (Tr. 179-180). The subscription fee during 1983 was $200.00 and increased every six months to $1,500. (Tr. 181; DE Ex. 17). The mails were used to distribute the Armstrong Report (Tr. 195-196, 203-204, 243, 629). Respondents represented that (DE Exs. 17, 18):

> Consistently [in the Armstrong Report] we have called the shots. The Armstrong Report continue to be on top of the metals like no other news service you have ever seen. We

call exact days, weeks and months and explain why by providing charts which clearly point out the cycles we have employed.

Armstrong Telephone Newsline tapes were provided by Respondent Armstrong through Respondents PEC and Report (Tr. 179, 273, 1763; DE Exs. 17, 18) and were taped telephone reports furnished by Respondent Armstrong which contained futures market recommendations and advice (Tr. 179, 206-207; DE Ex. 47). The telephone tapes were revised at mid-day and at other times depending on market activity (Tr. 209, 215).

Armstrong Telexes Newsline Communications were provided by Respondent Armstrong through Respondent PEC and were written reports of highs and lows and other price information (Tr. 1032-1033) "[T]he telex[e]s went out first and someone would take the telex and read it on a recording" for the Telephone Newsline tapes (Tr. 1283).

Seminar programs were provided by Respondent Armstrong through Respondent PEC (Tr. 176). These were weekend events, usually with 20 to 30 people in attendance and initially were held four times per year (Tr. 245-247, 438). The managed account programs were discussed (Tr. 248, 438-439).

> The mechanics and fundamentals of placing trading orders on the futures exchanges were covered (Tr. 435-436). Trading strategy and the use of commodity trend charts were taught (Tr. 248, 436-439).

14. It is the view of the Division of Enforcement that Respondents publications, subscription services, and other non-personal CTA activities to hundreds of customers are alone sufficient to place Respondents in that group of CTAs who must register (DE Memo. p. 26, 27). Several factors militate against this. *First,* it is unlikely that the CFTC Commission would apply an interpretation of the CEAct which the Supreme Court has rejected in its interpretation of the almost identical and prototype provisions of the Investment Advisor Act of 1940 in the case of *Lowe v. Securities Exchange Commission,* 472 U.S. 181 (1985). *Second,* the complaint in alleging a failure to register violation (I Comp. 12-13, 15, 17-18) is not limited to Respondents' activities regarding their publications and subscription services and other impersonal CTA services. *Third,* the facts in this record reflect an interwoven schematism of personalized and impersonalized CTA services. The Division of Enforcement's reliance upon Respondents' publications, subscription reports and other non-personalized CTA services standing alone is not adopted here. The decision at bar is based upon all of Respondents' CTA activities and other relevant conduct as established in the record.

15. During the times listed Respondents, for fees and other compensation advised, directly on a person-to-person basis, others as to the value or advisability of trading futures contracts or commodity options (Tr. 49-57, 80, 84, 148; Ex. 102). The following paragraphs numbered 16 through 20 concern clients

who received commodity trading advice on a person-to-person basis from Respondents for compensation or profit during the 12-month period October 1, 1983 to October 31, 1984 and the relevant portions of the record pertaining to these clients.

16. *John M. DeBlois,* an "entrepreneur investor", was Respondents' first managed account client (Tr. 43-44, 622). He learned of Respondents from a two-page advertisement in *Barron's* during the Spring of 1983. He concluded from reading the advertisement that Respondent Armstrong "was knowledgeable and experienced in advising people and also in advising people in the direction of the market." (Tr. 45-46). Later Mr. DeBlois made "a personal phone call to [Respondent] Armstrong" (Tr. 46) at a number listed in the advertisement. The two met and agreed to Respondent Armstrong handling a managed account, and he would make trades for Mr. DeBlois in the metals futures markets (Tr. 47, 58-59; DE Ex. 102). Trading was initially through E.F. Hutton Co. in New Orleans and then through Rudolf Wolff Commodity Brokers in New York with Leo Wetter as the account executive. Mr. DeBlois executed a power of attorney authorization to enable Respondent Armstrong to conduct the trading (Tr. 49-51, 69, 622; DE Ex. 57, 84). At the outset profits were realized in futures transactions in metals, silver, gold and platinum (Tr. 49, 52, 54; DE Ex. 107). The starting deposit was $200,000.00. After the initial profits, losses occurred and the account balance dropped to $131,000 (Tr. 49, 53-57). The account was closed November 21, 1983 (Tr. 57, 1379; DE Ex. 119). A beginning fee of 5-percent and a fee of 15-percent of the profits were paid to Respondent Armstrong (Tr. 49-50, 62). Respondent Armstrong made all the trading decisions in the account (Tr. 53).

17. *Jan Marks,* a floor trader on the New York Mercantile

Exchange and the Commodity Exchange, Inc. N.Y. (Tr. 2070-2071), started subscribing to the Armstrong Report in approximately February 1984, and used both the telephone newsline and the telex newsline (Tr. 2072-2073). Mr. Marks testified (Tr. 2066):

> Q. Have you been a consulting client? Did you pay whatever it is $1,000. or $2,000. an hour, to talk to him?
>
> A. Yes.

It was in late 1983 that Respondents' rate for consultation for commodity trading advice was $2,000.00 per hour (Tr. 181; DE Ex. 28, 41 p. 21, 45). Effective March 1, 1984 the per hour rate was established as $4,000. (Tr. 183, 1810; DE Ex. 42, p. 43). Mr. Marks is a full time market trader. His father is a member of the New York Mercantile Exchange and his brother has been chairman of the exchange for over eight years (Tr. 2070). Crude oil, gold and silver futures are traded by Mr. Marks. He trades for his own account and other managed accounts. Being a sophisticated trader, Mr. Marks continued with Respondents' services (Tr. 2070). He has "been very pleased with the performance record of [Respondent Armstrong's] recommendation through the Newslines, as well as his analysis of the markets" (Tr. 2069-2070).

18. *Mark M. Lively* is currently a cattle rancher and a commodity trading advisor (Tr. 377, 384). He became a subscriber to the Armstrong Reports in the Spring of 1983 (Tr. 396) as a result of reading an advertisement by Respondents in an issue of *Barron's* (Tr. 391-396). Mr. Lively reviewed the Armstrong Reports and the telephone newslines (Tr. 403).

Approximately three months after becoming a subscriber Mr. Lively talked to Respondent Armstrong via telephone (Tr. 417). Respondent Armstrong offered his personal consultation service. This had been partly the reason Mr. Lively had initiated the telephone call (Tr. 419). Mr. Lively testified (Tr. 420):

> Q. What did he say about the consultation?
>
> A. Well, he indicated that it was something special that he had for some of his larger clients and people that were pretty active in the market.
>
> * * * *
>
> Q. Did you ultimately subscribe to the personal consultation service with [Respondent] Armstrong?
>
> A. Yes I did.

The consulting service was used by Mr. Lively in formulating his decisions to trade in the precious metals futures market (Tr. 425-426, 516). From the Armstrong Report, newsline and seminars Mr. Lively learned that Respondents had a managed account program (Tr. 433). Mr. and Mrs. Lively became managed account clients in 1984 (Tr. 434, 517). A power of attorney granting control of the account was executed on July 23, 1984 (DE Ex. 67). On their behalf Respondent Armstrong traded "precious metals, gold, silver, platinum and the European currencies" (Tr. 446). In May 1985 Mr. Lively and his wife became employed by Respondents as market analysts (Tr. 449-450, 534). Mr. Lively deposited $300,000 in the managed account with Respondents. By trading in commodity futures Respondent Armstrong realized in a short time a $283,000 gain and was paid a management fee of approximately $50,858 (Tr. 520-523, 668). Subsequently, in 1985 all the managed accounts had large losses (Tr. 474). Mr. Lively's managed account was closed in the Summer of 1985 (Tr. 533). Mr. Lively and his wife left Respondents' employment in September 1985 after disputes concerning his work (Tr. 458, 474, 546-552). While Mr. Lively, when he left Respondents' employment, had some "bitterness and resentment toward [Respondent] Armstrong"; he was "careful" in his testimony "and tried to be fair, . . . to the best of his memory . . ." (Tr. 562, 597). I accept and credit Mr. Lively's testimony as truthful.

19. *Rudolf Wolff Commodity Brokers* employee, Leo P. Wetter, Jr., during the time involved here was an account executive assigned to deal with Respondents on behalf of Rudolf Wolff Commodity Brokers ("Rudolf Wolff Brokers"). In 1983 the firm changed its name to Rudolf Wolff Futures and later in 1986 it was acquired by Elders Futures (Tr. 615-616). As an account executive Mr. Wetter handled solicitation and the servicing of accounts trading futures contracts (Tr. 615). In August or September 1983 Mr. Wetter met Respondent Armstrong and a business arrangement was established whereby Mr. Wetter would act as the account executive for managed accounts referred by Respondents to Rudolf Wolff Brokers (Tr. 616, 1368, 1369). During September 1, 1983 through at least September 30, 1984 Rudolf Wolff Brokers received commodity trading services including personal consultations from Respondents (Tr. 665, 1379, 1384, 1402). Mr. Wetter and Respondent Armstrong spoke to each other on a daily basis (Tr. 680, 683). Mr. Wetter testified (Tr. 687-688):

> Q. Now, in addition to the seminars and telexes were there other services from Mr. Armstrong's companies that [Rudolf Wolff Brokers] received[?]
>
> A. Yes.
>
> Q. What were they?
>
> A. Charting services, technical and economic reports.
>
> Q. Right.
>
> A. And consultation on the markets via the phone.

Respondents were not paid separately for these services (Tr. 688-689). Compensation to Respondents from Rudolf Wolff Brokers for these services was factored into the broker's training of and salary for Bruce Winans, who later was to work for Respondents. The commission-sharing was a part of the overall arrangement (Tr. 688-689, 697, 1384). In addition to Mr. Wetter, other employees and customers of Rudolf Wolff Brokers were furnished Respondents' commodity trading advice including personalized consultation advice (Tr. 1361, 1380, 1384-1388, 1402, 1416-1417, 1420, 1423, 1446; DE Exs. 15-16). Respondents concluded their business relationship with Rudolf Wolff brokers' successor firm at the end of 1986 (Tr. 1464-1465).

20. *Additional managed account clients.* "Managed accounts" are accounts for which a power of attorney has been given by the account owner to another party to make trading decisions (Tr. 612). Respondents, in addition to power of

attorney from Mr. DeBlois and Mr. and Mrs. Lively, held and exercises powers of attorney to trade commodity futures and commodity options on behalf of the following clients (Tr. 625, 717-720, 765, 785-786, 788; DE Exs. 58, 59, 60, 61, 62, 63, 64, 65, 66, 69, 70, 119):

RESPONDENTS' ADDITIONAL MANAGED ACCOUNT CLIENTS

RESPONDENTS' CLIENTS	DATE OF POWER OF ATTORNEY
Brook Sec. & Tr. Corp., Ltd.	Nov. 10, 1983
Erexim Securities, Inc.	Nov. 11, 1983
Eagle Securities, Ltd.	Nov. 30, 1983
Michael B. Levy	Feb. 08, 1984
Anthony M. Nardo	Feb. 14, 1984
Edward M. Martinez	Apr. 09, 1984
Paul D. de Guidice	Apr. 13, 1984
Jeffrey Doremus	Apr. 17, 1984
Nohad Jean Hindi	May 16, 1984
Bruce D. Winans	May 24, 1984
Guy N. Ramsey	Aug. 13, 1984
John W. Shipman	undated*
Paul B. Heildrunn	undated**

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* Records of Rudolff wolff commodity Brokers show that Mr. Shipman's account was under Respondents' management in August 1984 (DE Ex. 119 p. 2).

** Mr. Heidrunn's power of attorney is undated (DE. Ex. 70). The reasonable inference from the record which is hereby adopted is that he was transacting management account business with Respondents on August 13, 1984, the date he witnessed Mr. Ramsey's signature on Mr. Ramsey's power of attorney form (DE. Ex. 68).

21. Respondent Armstrong called in by telephone almost all of the trades for the managed accounts to Rudolf Wolff Brokers (Tr. 628; DE Ex. 119 p. 2). Trading started September 1, 1983 (Tr. 649). Customer confirmations and monthly statements were prepared and mailed directly to the clients with copies mailed to Respondents (Tr. 629). As shown above, paragraphs numbered 15 through 20, Respondents during the period October 1, 1983 through October 31, 1984, had at least 17 clients to whom the Respondents were furnishing managed account advice or consultation advice *i.e.*, direct, personalized CTA services. I find and conclude that during that 12-month period Respondents willfully made use of the mails and other instrumentalities of interstate commerce in furnishing CTA services consisting of, *inter alia*, personalized commodity futures trading analysis, advice and management services to more than 15 persons.

C. Respondents held themselves out generally to the public as commodity trading advisors willing to provide personalized commodity trading advice.

22. Respondents extensively advertised their CTA services to the public. The record contains examples of advertisements by Respondents, written by Respondent Armstrong (Tr. 221), during the period March 1983 through June 1984 (DE Exs. 17-30, 75). Twelve of these advertisements were in *Barron's* (DE Exs. 17-28, 75). They follow the same general format. There is a listing of instances when Respondents, it is represented, were successful in predicting price movements for various commodities. This is followed by a text stating that the predictions of future prices is difficult and boasts of Respondents' past successes. In a typical advertisement in the April 4, 1983 issue of *Barron's*, it is represented that (DE Ex. 18):

"[I]n 1981 for the first time we began to publish our reports for everyone not just the insiders. . . . Consistently we have called the shots. The Armstrong Report continues to be on top of the metals like no other news service you have ever seen. We call exact days, weeks and months and explain why by providing the charts which clearly point out the cycles we have employed." After listing the reporting services available such as various reports and daily telephone messages the advertisements continue with (DE Ex. 18):

> In addition to all these services, the Armstrong Report will also provide personal consultation at the going rate of $1,500 per hour. This service can be utilized in two different ways. Those who wish to call for personal consultation regularly about the markets are billed on a per minute basis. Some of our clients use up 3 hours per week while others use merely 1 hour every three months. This service is only available by application and is very limited. It is also used by clients who like to have their investment portfolios analyzed. We will make recommendations as to how much in real estate, bonds, collectibles, metals or whatever. Again we do not make specific stock recommendations but rather suggest as to percentage of portfolio management. We also outline which areas to move into and out of for the years ahead and in what years shifts should take place again.

23. The advertisement concludes with a list of

Respondents' services and the costs to the client. Included as one of the choices available is "Personal consultation." Such clients were billed at a per minute rate based upon an hourly rate of $1,500.00. In the June 20, 1983 advertisement in *Barron's* the hourly rate for personal consultation was higher *i.e.* $2,000 per hour (DE Ex. 19). In the advertisements during June, July, August, September, October and November 1983 the personal consultation service was offered at a $2,000 hourly rate (DE Exs. 19, 20, 22, 23, 24, 25, 26, 27, 28). The response from the *Barron's* advertisements in 1983 was high, and the results were very productive for Respondents (Tr. 1980). There was a large influx of subscribers in 1983 (Tr. 1986). The two advertisements in the May 1984 and June 1984 *Futures* magazine are identical (DE Exs. 29-30). The heading "Armstrong Report" is prominent. It is stated in the advertisements that:

> The Armstrong Report is published monthly and covers gold, silver and platinum. The Armstrong Financial Report covers the currencies and is also serviced by a newsline three times daily. The Armstrong Stock Index report covers the futures Indexes along with the Dow Jones and S&P indexes. All three reports are published by Princeton Economic Consultants, Inc. which is one of the leading private consulting firms in the world. Our client base ranges from international corporations to middle east governments. Our hourly rates for private consultation are $4,000 per hour and even the Wall Street Journal last June confirmed in an article that our firm is one of the highest paid in the commodity field.

The June 1983 article in the *Wall Street Journal* is also referenced in Respondents' advertisement on July 11, 1983 in *Barron's* (DE Ex. 31) promoting a home study course on commodity futures trading authored by Respondent Armstrong. After quoting from the article, the advertisement stated that: "the Author is the highest paid consultant in the world." (DE Ex. 21).

24. On June 27, 1983 *Wall Street Journal* (DE Ex. 31) which Respondents quote approvingly in three of their advertisements in the record (DE Exs. 29-31) is under the headline: "For $33.50, You Can Have a Minute With This Commodities Advisor." Respondent Armstrong is described as "a commodity trading advisor in Lawrenceville, New Jersey [who] charges clients $2,000. an hour for private consultations. Those who don't need a full hour can talk to Mr. Armstrong for $33.50 a minute." (DE Ex. 31). The newspaper quotes Respondent Armstrong as stating during the interview that he "earns more than $100,000 a year giving phone advice to above 125 clients at $2,000. an hour; that's the equivalent of just a little more than a 40-hour workweek." (*Ibid.*). Respondents spent over $23,000 for advertising in 1983 (Tr. 2022; DE Exs. 38, 39).

25. When a new client became a subscriber, usually in response to the advertising, a package (Tr. 227) of informational papers was sent to the client (DE Exs. 41, 42; Tr. 223). The initial version, (DE Ex. 41), was used by Respondents for several months (Tr. 225, 227). Later, the first five pages were removed and DE Ex. 42 was substituted (Tr. 227-228). Respondents continued to send the material to new subscribers (Tr. 228). The paper was also distributed at Respondents' seminars in August 1984 (Tr. 440). As initially constituted and sent to new subscribers the package consisted of 25 pages with the title along the top and down the right margin of "Hello . . . how to use the

Armstrong Report." The advisory services of the Respondents are described and some review made of their commodity "trading systems which have proved to be extremely accurate utilizing the combination fundamental, cyclical and technical analysis" (DE Ex. 41, p. 1). The comprehensive scope and responsiveness to market developments and individualized needs of the offered services are stressed. The informational material states, in part, (DE Ex. 41, pgs. 1-4):

> How to use the Armstrong Report
>
> Hello
>
> We would like to welcome you to the Armstrong Report. Perhaps we should inform you that we are not a newsletter in the traditional sense. The Armstrong Report is completely and distinctly different. Our publications are a report of the continuous evolution in our research within the field of economic and financial analysis. As a subscriber, you will find that our publication as well as our seminars and other services are a true learning experience.
>
> The Armstrong Report is not based upon personal feelings or a bias towards one investment as opposed to another. You will also find that our comments are not vague or hazy generalizations which later come back as false claims that we called the top or bottom in a market. The Armstrong Report will make a specific trade recommendation

with a specific stop on every trade we suggest. Our specific trade recommendations are made primarily via our newsline service which is updated two to three times during the course of every trading day. Within this format, there is no room for false claims as to how we performed.

The Armstrong Report Inc. is a subsidiary of the Princeton Economic Consultants Corporation which is an organization devoted to research and development in financial and economic forecasting. Our recommendations are based upon our own unique trading systems which have proved to be extremely accurate utilizing the combination of fundamental, cyclical and technical analysis.

* * * *

Throughout the major part of 1981, we explained that the Armstrong Report was strictly a trade publication and was not made available to individual investors. However, by June 1981, the requests were so numerous that the time required just to answer the inquiries became overly burdensome. We added to our staff and that summer the Armstrong Report lifted its restrictions and for the first time allowed non-trade members to subscribe to our publications. Our first general advertisement then appeared in the

Appendix G

November 23rd issue of *Barron's* officially announcing that our report was available for general subscription.

* * * *

Our services are consultation oriented and are a vital integral part of the decision making for the financial future of our clients.

* * * *

As far as consulting is concerned, the *Wall Street Journal* as well as many other periodicals have carried articles normally headlining our $2,000 per hour consultation rates. Perhaps we are the highest paid consulting firm in the world, but our clients also claim that we are the best. Our consultation rate is charged on a per minute basis with only a 1 hour minimum per year requirement.

Our research staff is constantly charting and updating our information on ever commodity and economy on a daily basis. This provides the foundation upon which we can provide instantaneous consultation decisions of data.

* * * *

In reality, we are constantly spending what it takes to maintain that data and our clients

> are actually purchasing only the time they require to meet their own individual needs. Thus, our $2,000 per hour consultation rate is in reality a time sharing arrangement whereby individuals as well as multinational corporations share the benefits of this program. We incur the initial and major expense in assembling and maintaining the data enabling our clients to be able to access the most up to date information on a moment's notice without having to wait for some other research firm to provide them with a study that would require between 6 months to 2 years to complete. Instantaneous decisions require complete updated data and this is what we provide for $2,000 per hour on a moment's notice.

* * * *

26. Repondents in the material initially sent to new subscribers, also explained their commodity futures trading program (DE Ex. 41, p. 5):

> In addition to all our services, we also provide personal managed accounts and limited partnerships under a special trading subsidiary known as Economic Consultants of Princeton, Inc. Our personal managed account program is very limited and is based upon a commission of 20% of profits. If we do not produce a profit, we do not receive any fee or commission. Thus, our incentive is not

> to turn accounts but to produce. However, this subsidiary is also the general partner in limited partnership ventures into the trading medium. From time to time, we may have available limited partnerships for those who are interested in trading our recommendations but do not have the personal time themselves. In this way our busy clients can invest their assets in such manner that they know our trading systems and strict money management rules will be followed thus making him the benefactor of our years of experience and research in trading techniques.
>
> * * * *
>
> So we welcome you to the Princeton Economic Consultants group of companies. We hope that you will join with us and take advantage of the many services that we can provide. We believe that you will find no other organization between Hong Kong and Saudi Arabia that can provide you with the knowledge, experience, research and consultation necessary to survive the turbulent years that lie ahead.
>
> * * * *

When the material was revised and approved by Respondent Armstrong (Tr. 231), Respondents continued to seek new clients and subscribers. The materials (Tr. 233-234) offer the personal consultation concerning commodity futures trading and the managed account program (DE Ex. 42). Under the heading *"Personal Consultation Agreements"* Respondents state (*Id.* at p. 2):

> Many heavy traders prefer instantaneous personal consultation for their daily trading decisions. For this reason, Princeton Economic Consultants provides Personal Consultation Agreements. The consultation rate is $4,000. per hour charged on a per minute basis with an annual one hour minimum requirement. This rate has been headlined by the *Wall Street Journal* and other major periodicals as the highest consultation fee in the world. However, the cost to properly research just one market and assemble all the years of data into a viable format is in excess of $300,000. This service in reality is a time sharing arrangement whereby many individuals and firms share in the benefits of this program. As a consultation client, an individual has immediate access to up-to-date information on a moment's notice. This service is extremely beneficial due to the volatile and expenditious nature of the commodity markets.

27. Managed account participants are invited under the heading *"Managed Account Programs and Limited Partnerships."* Respondents state (*Id.* at p. 3):

> For investors who are interested in our trading recommendations but do not have the time to expend, we offer personal Managed Account Programs and Limited Partnerships. The clientele in our Managed Account Program is restricted to investors with a minimum capital investment of $1 million. Applicable fees are based on the percentage of profits generated in the accounts. In addition to this program, Economic Consultants of Princeton (a subsidiary of Princeton Economic Consultants) is the general partner in limited partnership ventures into the trading medium. By providing these two services, our busy clients can invest their assets and be assured that our trading systems and strict money management rules are adhered to.

During 1983 Respondents had approximately 500 subscribers and by 1984 there were approximately 1000 subscribers (Tr. 179). At seminars held by Respondents, both managed accounts and personalized advisory CTA services were promoted (Tr. 433-434, 439).

28. I find and conclude that from March 1983 to July 1985 the individual Respondent and the corporate Respondents, after they were established, intentionally and purposely and thereby willfully by their conduct indicated by use of mails and other instrumentalities of commerce that they were willing to provide person-to-person services to the public generally as commodity trading advisors.

D. Respondents, not having registered, willfully violated Section 4m of the CEAct, 7 U.S.C. § 6m, by transacting business as commodity trading advisors directly on a person-to-basis and by holding themselves out as commodity trading advisors offering such services.

29. Any commodity trading advisor who makes use of the mails or any instrumentality of interstate commerce in connection with personalized commodity trading advice must register with the CFTCommission unless exempted from registration as provided in Section 4m, 7 U.S.C. § 6m. A commodity trading advisor under the "broad definition" (*Commodity Futures Trading Commission v. Savage*, 611 F. 2d 270, 279 (9th Cir. 1979)) of that term in the CEAct who is within the scope of those covered and who is not exempted under the CEAct and who uses the mails or other instrumentalities of commerce while not registered with the CFTCommission violates Section 4m of the CEAct, 7 U.S.C. § 6m. *Commodity Futures Trading Commission v. British American Commodity Options Corp.*, 560 F.2d 135, 142 (2d Cir. 1977), *certiorari denied*, 438 U.S. 905. (The "flat prohibition of 6m against using the facilities of interstate commerce to give commodity advice unless registered" . . . underscores the CFTCommission's status in the enforcement of the CEAct in safeguarding the public interest in commodity futures markets). On September 30, 1983, shortly before Respondents established most of the managed accounts and personal consultation arrangements and after they had commenced holding themselves out, Respondent Armstrong in a CTA application (later withdrawn Tr. 1639; DE Exs. 8, 14 p. 3) stated that (DE Ex. 6; Tr. 1634, 1802-1803):

> the undersigned further understands that the applicant may not act as a . . . commodity

> trading advisor . . . for the period covering this application until the registration is effected.

Later respondent Armstrong insisted to the news media that he was in full compliance with the CEAct (DE Ex. 131; Tr. 1556-1560). I find and conclude that Respondents transacted business as commodity trading advisors and furnished personalized commodity trading advice in willful violation of Section 4m, 7 U.S.C. § 6m, as alleged in the first Complaint.

30. The only exemption in the CEAct possibly applicable here, and remotely so at that, is in the proviso that the regulation requirement is not to be applied if the commodity trading advisor *first*, "during the course of the proceeding twelve month, has not furnished commodity trading advice to more than fifteen persons and *second*, "does not hold himself out generally to the public as a commodity trading advisor . . ." Section 4m, 7 U.S.C. 6m (*supra* pp. 6-7). Respondents are unable to meet either of the two prerequisites for an exemption. As found and concluded *supra* pp. 13-17, Respondents had at least 17 clients during a previous twelve month period who were provided personalized CTA service via consultation or by a managed account arrangement. The exemption in Section 4m of the Act, 7 U.S.C. § 6m, is not to be given an overly broad construction. As "[i]n other security law contexts courts ordinarily defer to statutory purpose and narrowly construe exemptions from regulation" *Commodity Futures Trading Commission v. Savage*, 611 F.2d 270, 280, (9th Cir. 1979). The Court in that case also stated (*Ibid*):

> The registration provisions of the Act serve an important purpose: registration assures a public source of information about those upon whom customers rely and protects the

> public from individuals unfit to act as advisors.

Courts consider "the operation of unregistered commodity businesses to be of the most serious nature." *Commodity Futures Trading Commission v. Heritage Capital Advisory Services, Ltd.*, (D.C. ND Ill. 1982) Comm. Fut. L. Rep. (CCH) ¶ 21,627, p. 26,386.

31. I find and conclude that Respondents are clearly not within the first part of the proviso in Section 4m, 7 U.S.C. § 6m, concerning commodity trading advisors with not more than 15 clients and the registration requirement is applicable. The second part of the proviso "and who does not hold himself out generally to the public as a commodity trading advisor" also makes Respondents ineligible for the exemption. As determined *supra* pp. 17-24. Respondents by their conduct expressed a willingness to provide personalized commodity trading advisor services generally to the public and this brings them clearly within the concept of holding themselves out as commodity trading advisors generally to the public. The amount of deposit required from a managed account client was determined on a case by cases basis (Tr. 49, 121, 257). A person "holds himself out" to perform a service or particular calling by his conduct expressing his willingness to do such work for others. See, *Sanger v. Lukens*, 24 F.2d 226, 228-229 (D.C. Idaho, 1927) (A firm having elected by the manner of business operation to indicate that it "stands ready and willing to serve the public generally" is "holding itself out" by its conduct to be engaged in the regulated business and cannot escape such a determination by insisting on a different type of label). *Smitherman and McDonald v. Mansfield Hardwood Lumber Co.*, 6 F.2d 29, 32 (D.C. W.D. Ark. 1925) (Company willing to supply common carrier service to anyone is holding itself out as such to the public

and its requirement that there be private contracts with shippers does not alter its status).

32. Respondents did not limit or restrict their indicated willingness to provide the personalized advisory services in any significant manner. They are well within the concept of one who "hold[s] himself out generally to the public as a commodity trading advisor" Section 4m, 7 U.S.C. § 6m. Respondents by their advertising and other communications reach a considerable number of the public and are thus expressing themselves to the public. "The public does not mean everybody all the time." *Terminal Taxicab Co. v. Kutz*, 241 U.S. 252, 255 (1916). I find and conclude that Respondents are not within the proviso exempting from registration commodity trading advisors who do not have more than 15 clients during a 12-month period and who do not hold themselves out generally to the public as such advisors.

33. Respondents contend (Resp. Mem. 5, 7) that they are within the exemption contained in the definition in the CEAct of a commodity trading advisor for "(iv) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees . . . provided, that the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession" (Section 2(a)(1)(A), 7 U.S.C. § 2). Giving the exemption the "broad reading" appropriate for such publishers or producers (*Lowe v. Securities and Exchange Commission*, 427 U.S. 181, 206 (1985)) it is abundantly clear that the Respondents' prime business is their commodity trading advisor enterprise and rather than being a casual or accessory part of their publishing efforts the personalized CTA services were intended to be and were their major endeavor. Respondents, I find and conclude are not excluded from the CTA definition as publishers or producers of

any print or electric data. Respondents' claim (Resp. Mem. 3, 7-8) that they were exempt gold cash dealers also must be disallowed. Prior to 1983 Respondent Armstrong had some cash metals business (Tr. 173-174, 1975). By 1983, however this business was declining. Starting before May 1983, the primary business operation was providing and offering CTA services (Tr. 173-188, 1038-1040, 1180-1181, 1975, 1994, 2079-2080). A gold cash metals dealer is not exempt, as such, from the requirements of Section 4m of the CEAct, 7 U.S.C. 6m; see 54 Stat. 1059 (1940). The estoppel claim (Resp. Mem.2,8) is groundless. The applications were submitted in August 1984 (Resp. Ex. 2A) and issued July 2, 1985 (DE Ex. 14). The lack of registration violation was manifest shortly after the applications were submitted and before the end of 1984. None of the prerequisites for estoppel have been shown.

34. Respondents contend that the CTA activities challenged here "are protected by the First Amendment to the United States Constitution . . ." (Resp. Mem. 4-7). It is claimed that the CEAct if interpreted to reach Respondents' activities is unconstitutional. It is asserted that (*Id.* at 4):

> [Respondent] Resport engaged in the 'general and regular dissemination,' and the continuous, non-personalized and generally available publication for a fee, of economic and political information, though philosophy, opinions, analysis, history and recommendation . . . . This constitutes protected activity under the First Amendment. *E.g., Lowe v. Securities and Exchange Commission,* 105 S.Ct. 2557 (1985).

The Commission and the Courts have adopted the view that a question of whether an Agency's basic statute is Constitutionally allowable is most appropriately, under our legal system, to be reserved for and be determined by the Courts rather than the Agency. *In the Matter of American International Trading Company,* Comm. Fut. L. Rep. ¶ 21,127 (Commission decision Nov. 26, 1980), p. 24,568; See, *Panitz v. District of Columbia,* 112 F.2d 39, 41-42 (App. D.C. 1940). *Engineers Public S. Co. v. SEC,* 138 F.2d 936, 952-953 (App. D.C. 1943); "Beyond determining whether the statute is being properly interpreted and applied, this [Federal Trade] Commission has no authority to declare further" and rule upon the Constitutionality of the statute it administers. *The Blanton Co.,* 53 FTC 580, 593 (1956); 6 Pike and Fischer, Administrative Law 756 (FTC, December 26, 1956).

35. In *Savage v. Commodity Futures Trading Commission,* 548 F.2d 192, 197 (7th Cir. 1977), the Court rejected a similar First Amendment argument against the commodity trading advisor provisions in the CEAct. Moreover, the description of the conduct and activities of the Respondents as asserted by them and quoted above in paragraph 34, is totally incorrect. The record here clearly established that Respondents held themselves out generally to the public as person-to-person commodity trading advisors and conducted commodity trading advisor business with direct personalized advisor-advised relationships with more than fifteen persons. In *Lowe v. Securities and Exchange Commission,* 472 U.S. 181 (1985), the Supreme Court held that an injunction prohibiting the petitioners in that case from selling an investment advisory service was invalid under the Investment Advisors Act of 1940. The Court held that the publications were within the broadly read exclusion in the Act of bona fide publications and were not subject to an injunction under the Act. In its discussion the Court emphasized that "The Act was

designed to apply to those persons engaged in the investment-advisory professions — those who provide personalized advice attuned to a client's concerns, whether by written or verbal communication" 472 U.S. at 207-208. While the Act was sought to be unconstitutionally applied in that case its central thrust — to reach those giving advice of a personalized character — was intended by Congress to be free of Constitutional infirmities (*Ibid*). The Court in interpreting the Investment Advisors Act concluded that if protected activities were incidental or an insubstantial part of the nonexempt actions the advisor's conduct would be subject to regulation (472 U.S. at 204). The Court further held (472 U.S. at 210):

> The content of the publications and the audience to which they are directed in this case reveal the specific limits of the exclusion. As long as the communications between petitioners and their subscribers remain impersonal and do not develop into the kind of fiduciary, person-to-person relationships that were discussed at length in the legislative history of the [Investment Advisors] Act and that are characteristic of investment adviser-client relationships, we believe the publications are, at least presumptively, within the exclusion [for publishers] and thus are not subject to registration under the Act.

To the extent that the holding in the *Lowe* case is relevant to the instant case it supports the allegations of the complaint. It is determined, vis-a-vis Respondents' contention that the CEAct is unconstitutional, that the CEAct is being properly interpreted and applied to their business activities.

36. The claim (Resp. Mem. 7) by Respondents that Respondents' registrations as associated person and pool operator "adequately cover" and are sufficient to authorize the conduct of their challenged CTA activities cannot be accepted. Respondent Armstrong stated at the hearing that he and none of the corporate Respondents were registered before July 2, 1985, in any capacity with the CFTCommission (Tr. 1803-1804). An exhibit in the record is a certification by the Deputy Record Custodian of the National Futures Association. The custodian states that a review of the official CFTCommission records for January, 1983 through May 21, 1986 disclosed that (DE Ex. 14):

> Martin A. Armstrong was first registered as a Commodity Pool Operator (CPO) effective July 2, 1985 and has remained continuously registered in this capacity. The registration is due to expire July 31, 1986, unless renewed.
>
> Martin A. Armstrong was first registered as an Associated Person (AP) effective July 2, 1985 and has remained continuously registered in this capacity. He will maintain this registration as long as he is associated with his current sponsor.
>
> Armstrong Report, Inc. was first registered as a Commodity Trading Advisor (CTA) effective July 2, 1985 and has remained continuously registered in this capacity. This registration is due to expire July 31, 1986, unless renewed.
>
> An application for registration as CTA and

> CPO was submitted for Economic Consultants of Princeton, Inc. (E.C.P.I.), signed September 30, 1983, but the application was withdrawn before the registration was granted. A second application was received from ECPI on August 2, 1984 for registration as a CTA. The registration became effective July 2, 1985. This registration is due to expire July 31, 1986, unless renewed.
>
> Princeton Economic Consultants, Inc. (P.E.C.I.) is a cleared principal of Economic Consultants of Princeton, Inc. and Armstrong Report, Inc. PECI is not registered in any capacity.

The CTA activities while unregistered are alleged in the first complaint, and have been determined, to have occurred (*supra.*, pp. 10-24) within the periods March 1, 1983 through July 1, 1985 for Respondent Armstrong (I Comp. 11, 14-15), May 20, 1983 through July 1, 1985 for Respondent Report and Respondent PEC (I Comp. 15-16, 19) and May 27, 1983 through July 1, 1985 for Respondent ECP (I Comp. 17-18). The subsequent registrations effective on July 2, 1985 manifestly do not cover the previous conduct.

E. Respondents Armstrong, PEC and EPC failed to deliver to prospective and existing managed account clients disclosure documents in violation of Section 4.31 of the Commission's Regulations 17 C.F.R. § 4.31

37. Under counts V and VI of the first complaint (I Comp.

19-22) it is alleged that certain Respondents by the failure to properly provide to prospective and existing managed account clients disclosure documents violated Section 4.31 of the Commissions Regulations, 17 C.F.R. § 4.31. By their answer filed December 10, 1985, Respondents deny the allegation (I Ans. 2).

38. Regulation 4.31 provides in part, that:

> § 4.31 Disclosure to prospective clients.
>
> (a) No commodity trading advisor registered or required to be registered under the Act may solicit or enter into an agreement with a prospective client to direct the client's commodity interest, account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor *seeks* to direct the client's account or to guide the client's trading, in such form as the Commission may prescribe, containing [certain specified] information . . .

The record is clear that for the period identified in the first complaint, September 1, 1983 to August 2, 1984 (I Comp. 21, 22) Respondents' activities required that they be registered under the

CEAct as commodity trading advisors *supra*, pp. 10-28. It is also established in the record that Respondents solicited managed account clients and managed accounts for clients (*Ibid.*). Respondents' systematic trading program was based upon a strategy of "cyclical analysis" (Tr. 1814). During this time no disclosure document was provided to a client or any prospective client.

39. It is uncontroverted in the record that no disclosure document existed prior to the one dated August 15, 1984 (DE Ex. 15) which was prepared by Respondents' counsel (Tr. 255, 1464, 1641-1645). This disclosure document was prepared based upon the information provided by Respondents (Tr. 255, 1643).

40. It is admitted by Respondents that at no time prior to September 25, 1984 did Respondents ECP or Armstrong provide disclosure documents to the following managed account clients: Edexim Securities, Inc., Messrs, Levy, Ramsey, Martinez, Hindi and Lively. (Req. Ad. 20-22; Resp. Response ¶¶ 111, 113, 117, 119, 121, 123, 125). It is also admitted by Respondents that Respondents have never provided a disclosure document to the following managed account clients: Mr. DeBlois, Brook Sec. & Tr. Corp., and Eagle Securities, Inc. (Req. Ad. 22-23; Resp. Response ¶¶ 126-128). It is also admitted by Respondents that at no time prior to July 1, 1985 did Respondents provide disclosure documents to the following managed account clients: Messrs. Shipman and Herlbrum (Req. Ad. 23; Resp. Response ¶¶ 130-131).

41. Mr. Lively who had subscribed to Respondents' consultation service and who had become a participant in Respondents' managed account program on July 23, 1984 (Tr. 1262) testified that he never received a disclosure document

when he established his managed account (Tr. 444 See also 256-257). Respondent Armstrong testified that when Mr. Lively executed the power of attorney on July 23, 1984 a disclosure document was on the desk and Mr. Lively may have taken a copy with him (Tr. 1262). I do not accept Respondent Armstrong's testimony concerning such a delivery of a disclosure document to Mr. Lively. Mr. Lively denies such delivery occurred (Tr. 256-257, 444-445) and the only disclosure document that could have been involved is dated August 15, 1984 (DE Ex. 15), after the managed account was established.

42. Respondents' failure to properly deliver disclosure documents constitutes a serious disregard of necessary and key elements in the regulatory design. The important details required to be furnished in a disclosure document are carefully specified. In proposing the regulations requiring proper disclosure documents the Commission explained that such documents were a critical part of "a comprehensive scheme for the regulation of commodity trading advisors" *Commodity Trading Advisors: Proposed Regulations*, Comm. Fut. L. Rep. (CCH) ¶ 20,260 p. 21,411 (1977). The disclosures mandated would supply the information needed to make "a meaningful prospective evaluation of the value of the advisor's services" so that the prospective client may "make an informed decision as to whether or not to avail himself of the advisor's services." *Id.* at p. 21,414.

43. I find and conclude that Respondents Armstrong, EPC and PEC, were required to deliver, and willfully failed to deliver, proper disclosure documents to prospective and existing managed account clients for the period September 1, 1983 to August 2, 1984 in violation of Section 4.31 of the Commission's Regulations. Respondents' claim that they were excused from

any such obligation because they were not registered nor required to be registered (Resp. Mem. 9) is rejected.

F. Respondents Armstrong, ECP, Report and PEC failed to retain records as required by Section 4.32 of the Commission's Regulations.

44. Commodity trading advisors who are registered or who are required to be registered must retain and have accessible certain specified business records for specified periods. The record-keeping directives in Section 4.32 incorporate the requirements in Section 1.31. It is stated in counts VII and VIII of the first complaint (I Comp. 22-26) that between May 30, 1984, and September 30, 1985, Respondents failed to keep: (1) power of attorney authorizations executed by their managed account clients between September 1, 1983 through August 14, 1984, (2) confirmations of futures transactions for at least one of their managed account clients, (3) a manual titled "Hello how to use the Armstrong Report", and (4) advertisements published between March 14, 1983 and November 31, 1983. In their answer Respondents deny any violation (I Ans. 2).

45. A subpoena dated May 24, 1984 (De Ex. 1) was issued to the Respondents by the Division of Enforcement during the course of the investigation which proceeded the administrative complaints (Tr. 336-337). Respondents produced some of the items specified in the subpoena. (Tr. 338).

46. Particularly required by the subpoena were the following: (1) "all powers of attorney" in effect during January 1, 1983, to May 18, 1984, (2) account confirmation statements and monthly statements for Respondents' clients for the period January 1, 1984 through May 18, 1984, (3) "all forms of

advertisements published" by Respondents during January 1, 1983 through May 18, 1984, and (4) written publications distributed during January 1, 1983 through May 18, 1984. On July 30, 1987 a representative for the Division of Enforcement testified that no such documents were produced by Respondents in compliance with the subpoena for (1) powers of attorney (Tr. 343), (2) Respondents' client Mr. DeBlois' confirmation, purchase and sales statements or monthly statements (Tr. 349), (3) advertisements (Tr. 346) or (4) the publication "Hello how to use the Armstrong Report." (Tr. 348).

47. Susan Greenberg, an employee of Respondents, participated in a thorough search for documents responsive to the subpoena (Tr. 2010, 2012, 2016-2017; *See* Tr. 251-253; DE Ex. 1). Ms. Greenberg was Respondents' bookkeeper and had been an employee for approximately nine years (Tr. 1991, 1993-1994, 2023). "As far as" Ms. Greenberg knows the Division of Enforcement received all the documents Respondents had in 1984 which were responsive to the subpoena (Tr. 2017).

48. I find and conclude that between May 30, 1984 and September 30, 1985 Respondents as alleged in count VII and count VIII failed to keep powers of attorney authorizations, Mr. DeBlois' account transaction statements, advertisements and the manual "Hello how to use the Armstrong Report" in willful violation of Section 4.31 of the Commission's Regulations. The Respondents' claim (Resp. Mem. pp. 9-10) that because they were not subject to the registration requirements of the CEAct the record-keeping directives of the Regulations are inapplicable cannot be accepted.

49. The Commission and the Courts have recognized as essential the retention of business records and the link between

effective enforcement efforts and record-keeping mandates. *Commodity Trading Advisors: Proposed Regulations*, COMM. FUT. L. REP. (CCH) ¶ 20,260, p. 21,417 (1977). Record-keeping requirements have a "tendency to discourage the unlawful * * * [practice] at which the [CE] Act is aimed." *Bartlett Frazier Co. v. Hyde*, 65 F.2d 350, 352 (7th Cir. 1933), *certiorari denied*, 290 U.S. 654. *See also, United States v. Donahue Bros.*, 59 F.2d 1019, 1022 (8th Cir. 1932).

> G. Respondents Armstrong and ECP established and maintained a commission-sharing agreement with Rudolf Wolff Brokers, a brokerage firm, whereby Respondents secretly received portions of the commissions the broker charged Respondents' clients for executing trades.

50. In counts I and II, the second complaint states that starting before, at least, October 1, 1984 and concluding after June 1, 1986, Respondents Armstrong and ECP established and executed a commission-sharing agreement with Rudolf Wolff Brokers which was not disclosed to Respondents' clients (II Comp. 7-11). The undisclosed commission-sharing agreement, the second complaint asserts, was in violation of Sections 4*b*(A) and 4*o*(1) of the CEAct (II Comp. 9-10, 11). Respondents deny that any violations occurred (II Ans. 2-3).

51. The commission-sharing agreement consists of three distinct segments (1) October 1983 to April 1984, (2) April 1984 to October 1984 and (3) October 1984 to October 1986. The chronology and quiddity of the commission-sharing agreement was described at the hearing by Mr. Wetter, account executive, Rudolf Wolff Brokers. He testified that in early August 1983, he and Respondent Armstrong and Mr. Winans met to discuss

potential business opportunities (Tr. 617, 674). Mr. Winans was a friend and had been a roommate of Mr. Wetter during their attendance at college *(Ibid)*. Mr. Winans was also the brother of a friend of Respondent Armstrong (Tr. 1368).

52. *The October 1983 — April 1984 segment:* Mr. Wetter explained that at the August 1983 meetings (Tr. 617-618, 642):

> A. Specifically, we spoke of a proposal where Rudolf Wolff Commodity Brokers would hire Mr. Bruce Winans and train him and get him registered and with the intention after doing that of having Mr. Winans go back to [Respondent] Armstrong's business because [Respondent] Armstrong did need an assistant at that time.
>
> * * * *
>
> Q. . . . Was there any discussion about Rudolf Wolff carrying futures accounts for [Respondent] Armstrong's business?
>
> A. Yes, there was.
>
> Q. What was the nature of that discussion?
>
> A. Well, we discussed about the possibility of [Respondent] Armstrong directing some of his proposed managed account business to our brokerage house.

* * * *

> A. The discussion was that we proposed to hire, and train Mr. Bruce Winans until such time as he was licensed and proficient in the commodity futures business, and during that time [Respondent Armstrong] would trade some of his managed accounts through our brokerage firm.
>
> Q. Was there any discussion of any sharing of commission between [Respondent] Armstrong and Rudolf Wolff?
>
> A. Yes.
>
> Q. What was the nature of that discussion?
>
> A. It was discussed . . . it was proposed that the accounts that were held on Rudulf Wolf's books would be charged $50 a round turn and that the commission dollars from those accounts, when exceeding $200,000 gross, we would share 25 percent of the commission over and above $200,000.

An unsigned draft of the agreement between the parties is dated September 1, 1983 (DE Ex. 54; Tr. 643-645). The intent of the document was to reflect the discussion that had occurred in August 1983 (Tr. 645). After trading started in September 1983 further discussions were conducted (Tr. 649). Later, on October 21, 1983 Rudolf Wolff Brokers sent a letter to Respondent Armstrong outlining the terms of the agreement (De Ex. 55; Tr.

652). The parties adopted the agreement and "[g]enerally there was an agreement of ideas and principles and so forth" (Tr. 653). Also as a part of the terms of the commission-sharing agreement the CTA services provided to Rudolf Wolff Brokers, *i.e.*, Mr. Wetter's attendance at seminars sponsored by Respondents, telexes that Respondents provided, charting services, technical and economic reports "and consultation on the markets via the phone" (Tr. 686-688) were taken into account in establishing the amount or portion of the commissions allocated to Respondents (Tr. 689). No specific dollar value was placed on these CTA services by the contracting parties (Tr. 699-700). The commission-sharing agreement continued in effect approximately from October 1983 to April 18, 1984 (DE Ex. 56; Tr. Ex. 655). The aggregate business, however, was below the $200,000 threshold amount specified for the 25 percent share rebate to be paid (Tr. 655). No commission-sharing payments under the agreement occurred during this segment (Tr. 655).

53. *The April 1984 — October 1984 segment:* In April 1984, the parties agreed to suspend the commission-sharing agreement. In a letter dated April 18, 1984 to Respondent confirming this, Rudolf Wolff Brokers stated (DE Ex. 56): ". . . We have agreed that the commission rebated arrangement expressed in our October letter will not apply." The portion of the agreement concerning Mr. Winan's employment and compensation at Rudolff Wolff Brokers was extended to the next anniversary of the agreement, the first part of October 1984. (DE. Ex. 56; Tr. 653-655).

54. *The October 1984 — October 1986 segment:* In approximately October 1984 (Tr. 656-681) the commission-sharing part of the agreement was re-activated and a schedule of payments depending upon (1) the number of contracts traded and (2) the amount of commissions charged to Respondents' clients

for round turn trades executed by Rudolf Wolff Brokers was established. Payments to Respondents under the agreement began in December 1984 (Tr. 655-666, 796). Rudolf Wolff Brokers charged various commission fees to Respondents' clients for the execution of futures contracts transactions. These fees ranged from 15 dollars to 50 dollars for round-turn trades, ". . . with the vast majority probably averaging between the $15 and $20 range" (Tr. 660, 662; DE Ex. 127). The commission-sharing agreement and payments under the agreement continued to approximately October 1986 (Tr. 661). Mr. Winans ceased his employment with Rudolf Wolff Brokers approximately in October 1984 and started work for Respondents (Tr. 685).

55. As a part of the agreement under the *October 1984 — October 1986 segment* an estimate was made as to the amount of future trading business which would be referred by Respondents to Rudolf Wolff Brokers. It was determined, based upon their projections, that the percentage of commissions that would be paid Respondents would be $10,500 per month (Tr. 665). This amount was pre-paid starting in December 1984 for a period of about six months (Tr. 793; DE Ex. 125). When the parties reconvened it was recognized that "the level of business and level of activity and level of service rendered weren't as much as we expected; so, therefore, we dropped the number down to real numbers, the real trading numbers at that time" (Tr. 666).

56. Aida Samarizija was Rudolf Wolff Brokers' compliance officer during 1983-1987 (Tr. 711). Ms. Samarizija testified at the hearing. She explained that the accounting records of Rudolf Wolff Brokers indicated that commission-sharing payments to Respondents began in December 1984 and extended to December 11, 1986. The dates and amounts of the commission-sharing are listed on the following table. (Tr. 792-798, 802-803; DE Ex. 125):

Appendix G

UNDISCLOSED COMMISSION-SHARING PAYMENTS

Dates	Amounts	Payee
12/19/84	$10,500.00	PEC
01/21/85	10,500.00	PEC
02/20/85	10,500.00	PEC
02/20/85	963.22	PEC
03/18/85	10,500.00	PEC
03/27/85	10,500.00	PEC
04/19/85	10,500.00	PEC
05/02/85	10,500.00	PEC
[CATCH-UP PERIOD]		
12/17/85	4,233.50	PEC
03/14/86	2,339.50	PEC
04/15/86	2,417.00	ECP
07/18/86	3,355.25*	ECP
08/26/86	1,881.00	ECP
09/16/86	2,616.00	ECP
10/15/86	4,004.50	ECP
12/04/86	698.42	ECP
12/11/86	51.25	ECP
Total:	$96,059.64	

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* Includes amounts owed for April, May and June business.

When it was determined that the $10,500 monthly payments were too high considering the volume of managed account client business generated by Respondents, the payments were suspended on May 2, 1985 until the volume of managed account clients business caught up with the amount paid-out under the projection (Tr. 793-794). May 3, 1985 to December 17, 1985 was the catch-up period (Tr. 797-798).

57. During the commission sharing agreement Respondents were also paid management and performance fees by their managed account clients. Payments were made by Rudolf Wolff Broker pursuant to specific authorizations from Respondents' managed account clients (Tr. 785-788; 802-804, 806; DE Ex. 124; Resp. Ex. 124-A). At no time between October 1, 1984 and June 1, 1986 the dates designated in the second complaint (II Comp. p. 8) were Respondents' managed account clients other than those who were also employees informed of the commission-sharing agreement and the payments under the agreement. Mr. Wetter did not advise any of Respondents' managed account clients that there was a commission-sharing agreement (Tr. 667). Mr. Lively, one of Respondents' employees and a managed account client, remembered the first time he was informed of the commission-sharing and could "recall it vividly" (Tr. 470). Respondent Armstrong instructed Mr. Lively that in speaking to clients: " 'We don't want to mention any other brokerage house.' " "[H]e said, 'We want to recommend their use of Rudolf Wolff — New York, specifically Leo Wetter, because we get a piece of the action; we get kick backs from every trade they do' " (Tr. 469). Mr. Lively testified (Tr. 470-471):

> Q. To your knowledge, do you know whether [Respondent] Armstrong ever made known to his managed account clients that he

> was receiving kick backs on his commissions?
>
> A. Absolutely not. I was a managed account myself, and that was my first understanding of it. (See also Tr. 966).

58. Mr. Lively was initially "stunned" by the information and it took some time for "it to really soak in" (Tr. 471). He explained that "whenever you make trades and receive kick backs on the commissions . . . if you, in fact, have a set up like that, it is in your best interest to generate trades because you generate money at the same time" (Tr. 472). Respondent Armstrong instructed Mr. Lively not to inform "managed account clients that there was, in fact, this kick back arrangement" (Tr. 472).

59. Tobey W. Kaczensky, Associate Director of Trading and Markets, Commodity Futures Trading Commission, testified at the hearing (Tr. 992). Ms. Kaczensky stated based upon her experience, that the sharing of a client commission by a broker futures commission merchant and a commodity trading advisor creates a basic conflict of interest under the CEAct because it might encourage trading to benefit the advisor rather than the client (Tr. 997). The record establishes, and I so find and conclude that the commission-sharing agreement was not disclosed to clients, other than employees, by Respondents until approximately June 1, 1986 the date of the 1986 disclosure document (DE Ex. 118). I find and conclude that the undisclosed commission-sharing agreement existed between October 1, 1984 through at least June 1, 1986 as alleged in the second complaint (II Comp. p. 8).

60. The parties to the agreement were Respondents and

Rudolf Wolff Brokers. Respondents by use of the United States mail and other instrumentalities of commerce were to seek and direct futures trading business including that of client managed accounts to Rudolf Wolff Brokers. In return, Respondents were to receive a designated portion of the trading commissions paid by Respondents' clients to Rudolf Wolff Brokers for executed trades ordered by Respondents through Rudolf Wolff Brokers. I further find and conclude that the undisclosed commission-sharing agreement resulted in payments of at least $83,453.22 during the time designated in the second complaint (II Comp. p. 8).

61. The Commission has recognized that if a CTA "is to receive any share of [brokerage commissions charged to the client's trading account], the advisor may tend to issue buy and sell recommendations merely to generate commissions. Prospective clients and subscribers should be aware of this possible conflict of interests." *Commodity Trading Advisors: Proposed Regulations*, COMM. FUT. L. REP. (CCH) ¶ 20,260 pp. 21,414-21,415 (1977). Respondents in their transactions with clients were fiduciaries under the CEAct and were obligated to make full disclosure of any conflicts of interest. I find and conclude that the failure of Respondents Armstrong and EPC to disclose to clients the commission-sharing agreement between October 1, 1984 through June 1, 1986 constituted a willful violation of Sections 4b(A) and 4*o*(1) of the CEAct, 7 U.S.C. §§ 6b(A) and 6*o*(1).

62. It is difficult to overstate the gravity and importance of Respondents' violation of Sections 4b(A) and 4*o*(1) of the CEAct. The Commission has held that, *Klatt v. International Trading Group, Ltd.*, COMM. FUT. L. REP. (CCH) ¶ 20,6363, p. 22,593 (1978):

> The fiduciary nature of the relationship between a commodity trading advisor and his customer is beyond question. *Savage v. Commodity Futures Trading Commission*, 548 F.2d 192, 197 (7th Cir. 1977) . . . . It is a well-settled principle of securities law that it is the duty of a person who holds a fiduciary relationship to another person to make full disclosure of all material facts regarding the transaction between the parties. *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *American National Insurance Company of Galveston, Texas v. Murray*, 383 F.2d 81, 86 (5th Cir. 1967). In the Commission's view, this proposition is no less applicable to the commodities field. Indeed, given the volatility and intricacy of the commodity market mechanisms, such a rule is an absolute necessity.

63. Respondents contended at the hearing that the commission-sharing agreement and the payments thereunder to them were only for CTA services that they furnished to Rudolf Wolff Brokers. (Resp. Mem. 11-12; Resp. Prop. Fndgs. & Con. 13) Respondents' version of the facts is plainly an unacceptable afterthought. No direct cost or dollar value was placed on such services by Rudolf Wolff Brokers (Tr. 699-700, 1004). No accounting documentation correlating CTA services with commission-sharing was generated or preserved at Rudolf Wolff Brokers (Tr. 798-799, 801). No mention of such CTA services in return for the commission-sharing was made in the written memorizations concerning the commission-sharing (DE Exs.

56, 125, 127). Also significant is the circumstance that when the commissions-sharing agreement was suspended during the *April 1984 — October 1984 segment*, the broker-advisor relationship continued; however no substitute provision was made for the direct payments by the broker for CTA services. I find and conclude that the commission-sharing agreement and the payments pursuant to the agreement for the period October 1, 1984 to June 1, 1986 were primarily in exchange for Respondents' promise to direct trading business to Rudolf Wolff Brokers and the fulfillment of the promise. Compensation for CTA services was not a significant factor to the parties. It was not considered a critical or essential aspect of the arrangement and cannot be relied upon to explain, justify or excuse the undisclosed commission-sharing.

64. Conceptually, there is little difference between undisclosed commission-sharing with the variable amounts of the advisors' share dependent upon the number of trades ordered through the broker, as here, and undisclosed commission-sharing with the same variable amounts based upon business volume and some CTA services. Both are intertwined with the generation of commission revenue based upon business volume and the secret conflict of interest vice. With both arrangements the advisors may be encouraged to order for their own interest and benefit rather than for the best interest of their clients.

H. A corrected disclosure document was not issued by Respondents Armstrong and ECP within the time allowed by the Commission's Regulations.

65. Count III of the second complaint (II Comp. 11-12) asserts that Respondents Armstrong and ECP knew or should have known that the August 15, 1984 disclosure document (Tr.

265; DE Ex. 15) failed to correctly or accurately disclose the commission-sharing agreement in existence October 1, 1984 through June 1, 1986. By failing to timely correct or rectify the information furnished to clients, Respondents, the second complaint states, violated Commission Regulation Section 4.31(b). Respondents in their answer to the second complaint deny any violation (II Ans. 2-3).

66. It is admitted that the August 15, 1984 disclosure document was provided to some, but not all, of Respondents' managed account clients (Tr. 254-257; Reg. Adm. ¶¶ 110-121, 126-128; Resp. Response ¶¶ 110-121, 126-128). The August 15, 1984 disclosure document under the heading *Conflicts of Interest* states (DE Ex. 15, p. 7):

> . . . The Company [*i.e.* Respondent ECP] does not receive any percentage of commissions paid by the client to any futures commission merchant . . .

The August 15, 1984 disclosure document is nine pages and contains subheadings and a performance chart. No reference is made to the commission-sharing which was to be re-activated in October 1984 and under which payments were made to Respondents starting in December 1984 (DE Ex. 15). Employees of Respondent Armstrong testified that they knew of no amendment to the August 15, 1984 disclosure document after the commission-sharing was re-activated which informed clients of the advisor-broker payments (Tr. 259-260, 263, 265, 470-471, 966-967). Mr. Wetter, the employee of Rudolf Wolff Brokers who had the most contact with Respondents, testified that Respondents had two disclosure documents. "There was an earlier disclosure document and there was a later one" (Tr. 630).

The reference is to the August 15, 1984 document (DE Ex. 15) and the June 1, 1986 document (DE Ex. 16).

67. A draft of a proposed disclosure document dated September 1, 1985 was prepared on approximately August 14, 1985 and reviewed by Respondent Armstrong (Tr. 262-263; DE Ex. 113). The draft repeated the statement in the August 15, 1984 disclosure document under the heading "*Conflicts of Interest*" that "[t]he Company [*i.e.* Respondent ECP] does not receive any percentage of commission paid by the clients to any futures commission merchant" (Tr. 467; DE Ex. 113, p. 7). It was not until the 1986 disclosure document dated June 1, 1986 that Respondents' commission-sharing agreement was disclosed to clients (DE Ex. 16 p. 9).

68. I find and conclude that in October 1984 Respondents, knew or should have known that when the commission-sharing agreement was reestablished in October 1984 with payments to commence in December 1984, the disclosure document issued in August 1984 and the only such document existing until June 1, 1986 was materially inaccurate. It is further found and concluded that Respondents Armstrong and ECP willfully violated Section 4.31(b) of the Commission's Regulations by failing to correct the defect in the 1984 document and failing to distribute the correction to all existing clients within 21 days from October 31, 1984 as required by Commission Regulation 4.31(b)(1)(ii) and as alleged in the second complaint (II Comp. 11-12).

69. Respondents' violation of their obligation to timely distribute a corrected disclosure document containing a truthful description of the advisor-broker commission-sharing agreement to existing clients sealed-off of the clients from the opportunity to use the critical information in making their

investment decisions. Such a void is antithetical to the Commission's regulatory mission and is a serious and grave violation (See *Commodity Trading Advisors: Proposed Regulations*, COMM. FUT. L. REP. (CCH) ¶ 20,260 pp. 21,414-21,415).

70. Respondents argue that (1) they did not know and that they had no reason to know that the 1984 disclosure document should have been corrected, (2) they were relying upon their attorney to tell them if, and when, to correct relying upon their attorney to tell them if, and when, to correct the disclosure document, (3) Respondents were not required to be registered and (4) there was no knowing failure to correct the disclosure document (Resp. Mem. pp. 12-13). These contentions are not supported by the record and cannot be accepted. As commodity professionals it was Respondents' duty to inform themselves of their obligations under the regulations applicable to the industry. Respondents cannot close their eyes to what is clearly required by regulation and then successfully assert as excusable their conduct. As determined *supra* pp. 10-29, Respondents were required to be registered during October 1983 to June 1, 1985 and during that period, they failed to correct the disclosure document. Respondent actions were purposeful, intentional and willful. Respondents' claim that such elements are lacking cannot be credited. Respondents' employees repeatedly raised the issue of the need to bring the Respondents into compliance with the regulations but their efforts were disregarded (Tr. 265-266, 475-479. The willfulness aspect of Respondents' conduct also is discussed *infra*, pp. 50-51. The claim of reliance upon advice of attorney also lacks merit. There is no persuasive evidence that any attorney was fully advised of the facts concerning the secret commission-sharing agreement and then approved of the Respondents' actions in determining not to

disclose the agreement to their clients. The reliance upon advice of counsel also is discussed *infra*. p. 51.

> I. Respondents Armstrong and PEC issued advertisements concerning their offers of CTA services which contained false and misleading representations.

71. It is stated in the second complaint (II Comp. 13-18) that Respondents Armstrong and PEC engaged in false and misleading advertising in violation of Section 4.41(a) of the Commission's Regulations. Four advertisements are challenged. One of these was used twice. Respondents in their answer deny any violation (II Ans. 2).

72. Three of the advertisements involved were placed in *Barron's*. One was on October 14, 1985 (II Comp. Ex. A; DE Ex. 79); the second one was on November 24, 1985 (II Comp. Ex. B; DE. Ex. 80-A; and the third which repeated the November advertisement was in the December 9, 1985 (II Comp. 15, ¶ 40; II Ans. 1) issue. The fourth advertisement was placed in the January 6, 1986 (II Comp. Ex. C; De. Ex. 111) issue of *Investor's Daily*. All of the advertisements were for subscriptions for Respondents' Princeton Stock Index Report, and other services. The advertisements, the second complaint alleges, falsely represents that Respondents made trading profits in transactions involving actual trading in the S&P 500 stock index commodity futures market contract (II Comp. 14-17). It is further alleged that advertisements in *Barron's* falsely claimed a track record in the S&P 500 stock index futures contracts (II Comp. 14, 16). The second complaint also alleges that the advertisement in *Investor's Daily* falsely represents that the National Futures Association audited Respondents' claimed performance in the S&P 500 stock index futures (II Comp. 17).

73. In considering any advertisement alleged to be false, the threshold question is: what is represented when it is considered in its entirety? The discovery of this meaning is to be derived on the basis of the net impression a reasonable investor would have after reading its terms. The words used are not to be viewed in isolation, but are to be interpreted in their context. These principles are applied to the advertisements here to discern what the advertisements say.

74. *The October 14, 1985 advertisement in Barron's.* At the top of the October advertisement (DE Ex. 79) in large bold-face print is the statement "We Made $5,000 Per Contract In September Alone!" This statement clearly conveys the idea that Respondents had made a successful money commitment to the futures market. The text, after questioning whether investors may have some anxieties or concerns about their helplessness, uncertainty and confusion as to market development, refers to Respondents' past successes in predicting prices in various markets. Respondents indicate that they are active market participants with unique expertness compared to other market users. In the fourth paragraph on the left hand side it is represented that:

> In September 1985, our specific trading recommendations on the S&P Futures showed a $5,275 profit on 17 trades — per contract.

The use of the word "profit" in the context clearly projects the thought that there was a successful money commitment to the market. This is strong reinforcement for the idea conveyed by the bold face printing "We Made $5,000 Per Contract In September Alone!" at the top of the advertisement that there had been profits from actual trading transaction. Additional terms when considered in the overall context, such as the development of "successful" hedging models and claimed areas of market "expertise" combine to further the concept that Respondents are active market traders and made "$5,275 per contract" in September by actual trading. Moreover, Respondents supply more support for the idea that they are successful market participants by having the advertisement quote from the *London Times* that Respondents were "active in arranging international currency swaps."

75. The bar chart in the advertisement with various market entry and exit points indicated is labeled "Sept. S&P Futures Daily Track Record." By designating this as their "Track Record", Respondents clearly are saying to investors that actual market trading had occurred and was portrayed.

76. *The November 25, 1985 and the December 9, 1985 advertisements in Barron's*. At the top of the November and December advertisements, which are identical, in large boldface print, is the statement:

> We Made $11,150 Per Contract From Sept. 1st. — Nov. 11th, Trading The S&P

The November and December advertisements, for the most part, have the same tenor as that of the October advertisement. There is a similar indication that Respondents by their expertise, and successes afford a solution to the uncertainty, confusion and helplessness that an investor may have concerning efforts to anticipate market prices. In regard to their past successes and performance Respondents state in these advertisements that:

> In October we ran an ad in *Barron's* just after covering all our short positions into the September low. We made $5,275 per contract in September alone. After calling the low, we called the breakout on the S&P 500 to new highs while many were still saying that the Dow was a false indicator, blaming the rise on General Foods. But back in 1923 when the Dow took off to new highs everyone was still bearish, blaming the highs on an unusual extra dividend by US Steel. Well, while everyone was selling the market short in November we were aggressive buyers, and in the past three months we have made $11,500 per contract on S&P Futures.

The reference in bold face printing that "We made $11,150 Per Contract Trading The S&P" at the top of the advertisements and the description of the transactions, *i.e.*, "We were aggressive buyers, and in the past three months we have made $11,500 per contract on the S&P Futures" are claims that Respondents are market participants engaging in actual market trading with the represented profits as the result. This interpretation is furthered by the statement in the text: "We made $5,275 per contract in September alone" and the claim on the bar chart "Total Profits Per Contract traded at each specific buy and sell recommendation."

77. The bar chart in the advertisements, which various entry and exit points indicated, is labeled "S&P Futures Daily Track Record." Respondents, by designating their activity as their "Track Record", are clearly saying to investors that these are Respondents' actual market transactions.

78. *The January 6, 1986 advertisement in the Investor's Daily.* Respondent in their January 6 advertisement in the *Investor's Daily* start by comparing themselves favorably with other active traders, *i.e.*, investment portfolio managers. It is claimed that the "vast majority of such managers have been lost in a maze of confusion" (DE Ex. 111). Respondents assert that they have "been consistently on the right side of this market . . ." In the third paragraph of the advertisement Respondents represent that (DE Ex. 111):

> Our performance in the S&P Futures has been spectacular. Between September 1 and November 22, we produced $13,125.00 per contract traded at each specific recommendation on 48 trades. We sold the market right into the September low and turned around and bought it right up to the highs. The results were audited by the National Futures Association.

Respondents represented here that they were active market traders. The claims that "we produced $13,125.00 per contract traded at each specific recommendation . . .," "we sold the market . . ." and "bought [the market]" conveys to an investor-reader that Respondents had achieved high market gains and had produced the amount reported through market trades. Nothing in the advertisement dispels or detracts from this interpretation. The claim that the "results were audited by the National Futures Association" is accordingly a representation that the claimed gains from actual trading were reviewed and verified by the National Futures Association ("NFA").

79. I find and conclude that Respondents in the challenged

advertisements intended to and did represent that the monetary results claimed were derived from actual trades placed by them on the future market. It is conceded by Respondents that no such actual trades were made (Tr. 1333, 1342; See also Tr. 460-461, 867, 929). Respondents contend that the advertisements concern only their recommendations and should not be read to say that they claim the results to be based upon actual trades. (Resp. Mem. 14) I have assessed and weighed all the terms of the advertisements which represent that Respondents were basing their successful market gains on actual trades against other terms in the advertisements which might possibly dispel or arguably remove such an interpretation and leave the impression that only recommendations were involved. To be sure, the advertisements talk about Respondents' client recommendations but this is not inconsistent with profits or gains from Respondents' actual trading. The advertisements go further than descriptions of recommendations by the use of words such as "total profits," "we made," "bought it," "we sold at the market" "we have made" and "we were aggressive buyers." The words considered in their context, show through their unity of composition that Respondents were striving for and succeeding in willfully misrepresenting that they had made market profits or gains based upon actual trades. The claim that the NFA had audited Respondents' trading and claimed results was also willfully false and misleading. There were no actual trades or profits to audit. (Tr. 460, 854, 1333, 1342). I find and conclude that Respondents Armstrong and PEC willfully engaged in false advertising in violation of Section 4.41(b) of the CFT Commission's Regulations as alleged in the second complaint (II Comp. pp. 13-18).

> J. Respondents Armstrong and PEC in advertisements presenting simulated or hypothetical performance results violated the CFT Commission Regulation by failing to include the required statement in such advertisements.

80. It is stated in count VI of the second complaint (II Comp. 18-19) that Respondents violated Section 4.41(b) of the Commission's Regulations by their advertisements on October 14, 1985, and November 24, 1985 in *Barron's* (D.E. Exs. 79, 80-A) and on January 6, 1986 in *Investor's Daily* (D.E. Ex. 111) which set forth simulated or hypothetical trading results. Such advertisements failed to prominently disclose the cautionary statement required by Section 4.41(b)(1). Respondents in their answer deny any violation (II Resp. Ans. 2).

81. Section 4.41(b)(1) of the CFT Commission's Regulations provides, in part, that:

> No person may present the performance of any simulated or hypothetical commodity interest account, transaction in a commodity interest or series of transactions in a commodity interest of a commodity pool operator, commodity trading advisor, or any principal thereof, unless such performance is accompanied by the following statement: "Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under-or-over compensated for the impact, if

> any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown.

As determined *supra* pp. 42-46, the Respondents' advertisements represented asserted profits or results that were money gains derived from actual trades and this was false. Such transactions, not being actual trades, are hypothetical or simulated performances and the required caution quoted above was mandatory.

82. Moreover, even if the advertisements are granted the interpretation contended for by Respondent (Resp. Mem. 13-14; Resp. Prop. Fndgs. & Con. 15-17), that the advertisements are limited to promoting Respondents' recommendations, the simulated or hypothetical character remains — no actual trades are involved — and the required caution was mandatory. I find and conclude that Respondents willfully violated CFT Commission Regulation 4.41(b) as alleged in the second complaint.

83. In its Report dated August 12, 1976, the CFTC Advisory Committee on Commodity Futures Trading Professions recommended that the (*Trading Professional Advisory Report*, COMM. FUT. L. REP. (CCH) ¶ 20,197, p. 21,099 (1976)):

> [a]dvertising of theoretical, hypothetical or simulated results should be flatly prohibited as it is simply too easy to manufacture impressive but fictitious statistics.

In the proposed Regulations the CFTCommission issued on February 15, 1977 (*Commodity Trading Advisors: Proposed Regulations*, COMM. FUT. L. REP. (CCH) ¶ 20,260, p. 21,417 (1977) and on August 4, 1980 (*Pool Operator and Advisors Rules Revision*, COMM. FUT. L. REP. (CCH) ¶ 21,057, p. 24,240 (1980) a ban against such advertising was suggested and comments and alternative proposals were invited. In August 4, 1980, the CFTCommission said (*Id.* at p. 24,243):

> [T]he Commission has found the use of hypothetical and simulated models to constitute a major area of large-scale customer abuse. Therefore, the ban appears to be necessary to adequately protect commodity customers from misleading performance claims — particularly claims made by persons with limited experience in the management of commodity interest accounts. The Commission specifically requests interested persons to submit alternative proposals to regulate the advertising of actual and hypothetical performances by CPOs and CTAs.

Thereafter, on May 8, 1981 when the Commission issued the final Regulation 4.41, it was noted that (*Revision of Pool Operator and Advisor Rules*, COMM. FUT. L. REP. (CCH) ¶ 21,188, p. 24,903 (1981)):

> [W]ith respect to the advertising of simulated or hypothetical past performance results, the Commission has determined not to adopt at this time a rule that would prohibit

> such advertising. Instead, the Commission has adopted a rule that allows the presentation of those results, provided that the presentation is accompanied by the statement prescribed in the rule. Section 4.41(b). This statement is intended to alert prospective customers to the limitations inherent in simulated and hypothetical past performance results.

84. Respondents contend that their advertisements were within the protection afforded "free speech advertising" under the Constitution (Resp. Prop. Fndgs. & Con. 17; Resp. Mem. 13), *i.e.*, that Regulation 4.41(b)(1) conflicts with the "commercial speech" protection under the First Amendment. As noted *supra* p. 27, there is limited jurisdiction here to consider Respondents' assertions that the CEAct is invalid under the Constitution. The same constraint is present with respect to Respondents' attack on Regulation 4.41 as Constitutionally invalid. See *Finnerty v. Cowen*, 508 F.2d 979 982 (2d Cir. 1974) ("Federal agaencies . . . have neither the power nor the competence to pass on the constitutionality of administrative or legislative action.").

85. Only an assessment of the interpretation and application of the Regulation is set forth here. It has been frequently noted that false or misleading advertisements have no commercial speech protection under the First Amendment. See *Posadas de Puerto Rico Assoc. v. Tourism Co.*, 478 U.S. 328, 340 (1986); *Bolger v. Youngs Drug Products Corp.* 463 U.S. 66, 68 (1983). As commercial speech, the Respondents' advertisements are not protected from reasonable regulation necessary to prevent them from being "misleading" or "more likely to deceive the public than to inform it." *Central Huydson Gas & Elec. v.*

Public Serv. Commission, 447 U.S. 557, 563-564 (1980). The CFT Commission's regulation is a "limited supplementation by way of warning or disclaimer, or the like . . ." *Bates v. State Bar of Arizona*, 433 U.S. 350, 384 (1977). It is conceded, as alleged in the second complaint paragraphs 37, 40 and 43 (II Comp. 13-16; II Resp. Ans. 1) that the newspaper items are "advertisements". Each of the items has as its "core notion" a proposed "commercial transaction". "Specific products" are featured and Respondents have "an economic motivation" for the newspaper items. Accordingly, the advertisements constitute and "are properly characterized as commercial speech" even though they may contain references to important public issues. *Bolger v. Young Drug Products Corp.*, 463 U.S. 60, 66-68 (1983).

86. The central nature of Respondents' representations is to convey to potential clients that Respondents have accurately predicted market prices with the potential client to conclude that Respondents will likely continue such accurate forecasting. The Commission has recognized *supra* p. 47, that portrayals of successful hypothetical or simulated results have strong and compelling potential foi abuse and deception for investors. The prescribed caution is be included in any such advertisement in order to bring to the readers' attention material factors in an intensely complex investment arena. Under "commercial speech" a corrective regulation may be coextensive in breadth with the perceived threat of misrepresentation, and a regulation " may deal effectively with false, deceptive, or misleading sales techniques" (*Id.* at 69).

87. The required caution is within the CFTCommission's regulatory interest in protecting investors. The precisely crafted content-based requirement in Commission Regulation Section 4.41(b)(1) goes no further than necessary in protecting against

commercial harm. In the specialized arena of investment regulation Courts have authorized requirements, such as here, that a potential market investor receive information or disclosures in order to counter any investor misunderstanding. See *S.E.C. v. Wall Street Pub. Institute, Inc.*, 851 F.2d 365, 373-374 (D.C. Cir. 1988).

II. The violations by Respondents warrant imposition of sanctions and such sanctions should be those which will effectuate the purposes of the Act.

A. It is determined that the nature and gravity of the proven violations make appropriate the imposition of specified sanctions.

88. The two complaints request as sanctions in this proceeding, if it is determined that the allegations are correct, that an Order be issued, (1) revoking or suspending the registrations of the Respondents, (2) assessing a civil penalty of not more than $100,000.00 for each violation of the CEAct or Regulations, (3) requiring Respondents to cease and desist the activities found to be in violation of the CEAct and Regulations, and (4) barring Respondents from trading on or subject to the rules of any contract markets and to refuse trading privileges to these Respondents (I Comp. 27-28; II Comp 20-21).

89. It is contended by Respondents (Resp. Mem. 2) that any suspension or revocation of Respondents' registrations would be contrary to the provisions of former Section 9b of the Administrative Procedure Act, as reenacted and recodified, 5 U.S.C. § 558, *viz*:

> (c) * * * Except in case of willfulness or

> those in which public health, interest, or safety requires otherwise, the withdrawal, suspension, revocation, or annulment of a license is lawful only if, before the institution of agency proceedings therefore, the licensee has been given —
>
> (1) notice by the agency in writing of the facts or conduct which may warrant the action; and
>
> (2) opportunity to demonstrate or achieve compliance with all lawful requirements.

In *Eastern Produce Co. v. Benson*, 278 F.2d 606 (3d Cir. 1960), a case involving the suspension of a license issued pursuant to the perishable Agricultural Commodities Act, it was held that "where willfulness can be shown on the part of the individuals violating valid regulations, license suspension is authorized without resort on the part of the agency to notice and opportunity for compliance" (278 F.2d at 609). The holding of the Court in *Eastern Produce Co. v. Bension, supra*, was followed in *Goodman v. Benson*, 286 F.2d 896 (7th Cir. 1961), a case under the CEAct in which it was held that 280 F.2d at 900:

> petitioner urges his denial of trading privileges mounted to a suspension of a license, and that section 9(b) of the Administrative Procedure Act . . . was violated. We do not reach that question for the same section excludes cases of willfulness. We hold the petitioner's conduct was willful

> within the meaning of section 9(b) of the Administrative Procedure Act. We think it clear that if a person 1) intentionally does an act which is prohibited—irrespective of evil motive or reliance on erroneous advice, or 2) acts with careless disregard of statutory requirements, the violation is willful.

The findings and conclusions and the evidence show that the violations were willful (*supra*, pp. 16, 24-25, 31-32, 38, 41, 46-47). It is sufficient if the findings and evidence show that the violations by Respondents were intentional, and it is not necessary, in addition, to prove bad faith or an evil purpose. *Cargill Inc. v. Hardin*, 452 F.2d 1154, 1163-1164 (8th Cir. 1971), *certiorari denied*, 406 U.S. 932; *Goodman v. Benson*, 286 F.2d 896, 900 (7th Cir. 1961); *Eastern Produce Co., Inc. v. Benson*, 278 F.2d 606, 609 (3d Cir. 1960); *Great Western Food Distributors v. Brannan*, 201 F.2d 476, 484 (7th Cir. 1953), *certiorari denied*, 345 U.S. 997; *Air Transport Associates v. Civil Aeronautics Bd.*, 199 F.2d 181, 186 (D.C. Cir. 1952), *certiorari denied*, 334 U.S. 922.

90. It is contended that Respondents relied upon advice albeit "erroneous and/or unsagacious" (Resp. Memo. 2) of counsel who authorized the unlawful activities (Resp. Memo. 8, 12). It is claimed that Respondents' violations were not "because [Respondent] Armstrong didn't row as hard as he could" (Tr. 1915). The requirement in a good faith defense based upon reliance upon an attorney's advice is that the party must first be candid with the attorney. Essential is the demonstration that counsel was fully informed as to all relevant facts *United States v. Auster Channel Wing Corp.*, 376 F.2d 675, 683 and fn. 15 (4th Cir. 1967); *United States v. Stirling*, 571 F.2d 708, 735 (2d Cir.

1978), *certiorari denied*, 439 U.S. 824; *United States v. King*, 560 F.2d 122, 132 (2d Cir. 1977), *certiorari denied* 434, U.S. 925; See *Tarvestad v. United States*, 418 F.2d 1043, 1047 (8th Cir. 1969), *certiorari denied* 397 U.S. 935. It is conceded by Respondent Armstrong that the attorneys whose advice is relied upon were not supplied with all relevant information concerning Respondents' activities such as Respondents' files (Tr. 1864), advertisements and promotional materials (Tr. 16, 252, 1549-1552). None of the counsel testified at the hearing. Respondents claim that written opinions were received from counsel confirming that their activities were lawful (Tr. 1541-1545, 1856-1857). No such written opinions were offered at the hearing or received in evidence. No explanation as to the missing written opinions was tendered. Respondent Armstrong testified that he had received such advice from counsel (Tr. 1110, 1545, 1856-1857). No persuasive collaboration of this testimony was offered. I do not find such testimony creditable or acceptable. Respondents' attempt to transfer the obligation to comply with the CEAct and the Commission's Regulations to their counsel is not permitted. I find and conclude that Respondents have not established their claim of good faith based upon advice of counsel and this defense must be rejected.

91. An examination of the record, including a full review of the submissions of Respondents has disclosed no creditable evidence establishing mitigating or extenuating factors concerning Respondents' violations. Similarly, convincing evidence of rehabilitation has not been produced. No apparent bar exists to the application of sanctions and these sanctions should be the result of a careful measuring and weighing process. Such sanctions are based upon the gravity of each violation and the sanctions should discourage further violations of the CEAct by Respondents and by others who may be tempted to follow

Respondents' example. It is found and concluded that Respondents are unfit for registration under the CEAct. Accordingly, it is determined that an Order should be issued pursuant to Section 8a(4) of the CEAct, 7 U.S.C. § 12a(4), revoking the registrations of Respondents.

92. Respondents shall be ordered to cease and desist from the acts and practices which have been found to have violated the CEAct. Such provisions in an Order are authorized by Section 6(c) of the CEAct, 7 U.S.C. § 13b. I have balanced the need for a cease and desist order against the likelihood of future violations by Respondents (See *In the Matter of Dillon-Gage, Inc.*, COMM. FUT. L. REP. (CCH), ¶ 22,574 (CFTCommission Decision, 1984) p. 30,483). Respondents, at a future time, may become re-registered. Nothing in this record affords any basis for any assurance that the violations will not be repeated. The nature and circumstances of the violations convince me that an effective Order must include such cease and desist provisions.

93. Respondents shall also be prohibited from trading on or subject to the rules of any contract market for a specified period. This sanction is authorized by Section 6(b) of the CEAct, 7 U.S.C. § 9. It is determined that Respondents should be prohibited from trading for a period of twelve (12) months.

94. As noted, civil penalties up to $100,000 per violation are listed in the complaints as possible sanctions. The Division of Enforcement has recommended a tentative civil penalty assessment in the total amount of $100,000 against each Respondent for a total amount of $400,000. (DE Mem. 44). Section 6(b) of the CEAct, 7 U.S.C. § 9, authorizes as a sanction, upon a determination that there has been violations, an assessment of a "civil penalty of not more than $100,000 for each

such violation." The primary business of Respondent at the time of the violations involved use of the commodity futures markets. In determining the amount of any money penalty assessed, the criteria stated in Section 6(b) of the CEAct, 7 U.S.C. § 9, has been applied. See *Premex, Inc., et al. v. Commodity Futures Trading Commission*, 785 F.2d 1403 (9th Cir. 1986). I find and conclude that the amount assessed here is appropriate to the size of the futures market business conducted by Respondents and the gravity of the unlawful and willful conduct. The violations established in this record authorize an amount which would deter future violations. I have also taken into consideration the financial circumstances of Respondents to the extent such information is available. Based upon my review of these matters, it is determined that the following civil penalty should be tentatively assessed against Respondents:

— Respondent Armstrong is assessed $3,000 as to reach of the violations listed in the three counts in the first complaint (I Comp. 1, 21, 25-26) and listed in the five counts in the second complaint (II Comp. 9-12, 17-19) determined to have been established against this Respondent for a total of $24,000.

— Respondent EPC is assessed $2,000 as to each of the violations listed in the three counts in the first complaint (I Comp. 18, 21, 25-26) and listed in the three counts in the second complaint (II Comp. 9-12) determined to have been established against this Respondent for a total of $12,000.

— Respondent PEC is assessed $2,000 as to each of the violations listed in the three counts in the first complaint (I Comp. 19, 22, 26) and listed in the two counts in the second complaint (II Comp. 17-19) determined to have been established against this Respondent for a total of $10,000.

—Respondent Report is assessed $2,000 as to each of the violations listed in the two counts in the first complaint (I Comp. 16, 25-26) determined to have been established against this Respondent for a total of $4,000.

B. The amounts of civil penalties here are provisional or tentative; the parties have the opportunity to submit additional facts or contentions concerning such civil penalties.

95. These amounts are provisional or tentative determinations. Notice of a hearing will be a part of the Order herein. Upon consideration of any evidence submitted at such hearing and upon consideration of any objections by the parties, a Final Order establishing sanctions including any civil penalty will be issued. See *In the Matter of Rothlin*, COMM. FUT. L. REP. (CCH), ¶ 21,851 (CFTCommission Decision, 1981), p. 27,574; *In the Matter of Nelson, Ghun & Associates, Inc.*, COMM. FUT. L. REP. (CCH), ¶ 22,255A (CFT Commission Decision, 1984), p. 29,340.

96. All of the contentions relating to the complaint and answers presented by the parties on the record at this stage of the case have been considered. Not all of these contentions have been specifically mentioned. Any such matters inconsistent with the determinations herein are found and concluded to be without merit.

Appendix G

Based upon the foregoing Findings of Fact and Conclusions of Law, I issue the following:

ORDER AND NOTICE OF HEARING

I. The allegations of the complaints are SUSTAINED.

II. Respondents' registrations under the CEAct are hereby REVOKED.

III. Respondents are directed to CEASE AND DESIST from engaging in the violations of the type determined here of the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.*, and the Commission's Regulations found herein.

IV. Respondents are prohibited from trading on or subject to the rules of any contract market for a period of twelve (12) months from the date this Order becomes final. All contract markets shall refuse all trading privileges to Respondents until the expiration of the twelve (12) month period. Such prohibition and refusal shall apply to all trading done and positions held directly by Respondents, either for their own individual accounts or as agent or representative of any other persons or firm, and to all trading done and positions held indirectly through persons or firms owned or controlled by Respondents or otherwise.

V. Respondents are assessed and shall pay to the Commodity Futures Trading Commission, thirty (30) days after this Order becomes final, a civil penalty in the amounts listed:

—Respondent Armstrong	$24,000.
—Respondent EPC	$12,000.

—Respondent PEC	$10,000.
—Respondent Report	$4,000.

VI. The civil penalty assessments are tentative. The sanctions directed herein are held in abeyance until further Order.

VII. *NOTICE* is hereby given of a *HEARING* commencing at 10:00 a.m. on December 18, 1989 at a courtroom to be designated in New York City, New York, to receive evidence and any objections as to whether there should be any civil penalty or amount thereof. Any party intending to participate in the scheduled hearing is directed to file and serve by no later than December 5, 1989, a *STATEMENT* of such intent and to indicate therein matters intended to be presented by the party together with a brief statement of the evidence proposed to be offered. If no such *STATEMENT* is filed and served by a party within the time allowed the party shall be deemed to have waived participation in any further proceedings prior to the issuance of a final Order herein.

VIII. After the hearing provided herein and any additional proceedings considered warranted, an Order will be issued establishing sanctions including any civil penalty assessment determined to be appropriate. Such subsequent Order shall provide for the final disposition for purposes of Section 10.102 of the Commission's Rules of Practice, 17 C.F.R. § 10.102.

APPENDIX H — EXCERPTS OF TRANSCRIPT OF PROCEEDINGS

[Commencing at p. 892]

Q. Right. Let me try to help you, okay? You're going to have to help me as we go through this, but I'll try to help you on this one.

Do you remember Armstrong saying on the phone to Loughren, I don't care if they are not entitled to audit it, because it is free speech. We are already having a lawsuit with the CFTC. It's too much attorney's fees. The records are accurate. I'm just going to give it to them?

MR. SUE: Objection, Your Honor, compound question and also hearsay.

BY MR. LOVELL:

Q. Words of substance do you remember that?

JUDGE DUNCAN: Do you understand the question?

THE WITNESS: Yes, I think I understand the question.

JUDGE DUNCAN: All right. Overruled.

THE WITNESS: I recall having a discussion myself with Mr. Loughren about the issue of jurisdiction, I guess.

BY MR. LOVELL:

Q. Right.

Whether the CFTC could have jurisdiction to look into what Loughren was calling free speech; right?

A. Right. And he referred to the Low decision I think it was.

[893] Q. Well, yes, he was saying — he was basically — Loughren was telling you you have no jurisdiction over this in words or substance, right?

A. Yes, I believe he made that statement.

JUDGE DUNCAN: Mr. Lovell, we'll take a short recess.

(Brief recess.)

JUDGE DUNCAN: On the record.

Mr. Lovell, before we go further, I have Administrative Law Judge Exhibit No. 1, the protective order I proposed to receive in evidence. Any objection?

MR. SUE: No objections, Your Honor.

MR. LOVELL: No objection.

JUDGE DUNCAN: All right. ALJ Exhibit No. 1 is received.

> (The document referred to above was marked Administrative Law Judge Exhibit No. 1, for identification and was received in evidence.)

BY MR. LOVELL:

Q. Basically Loughren was trying to convince you that the NFA didn't have jurisdiction to pass on the advertisements, to look into them, right?

A. I guess so.

[894] Q. Yes.

And basically in your presence, you were asking Armstrong about it and Armstrong said over the phone to Loughren, Tom, you're probably right, but the CFTC is looking into it, so we already have attorney's fees — CFTC already brought a complaint against us. We already have attorney's fees. The ads are correct. There is no problem. I'm going to let the NFA look at it in words or substance, right?

A. I don't remember specifically sitting there while that took place. That was the feeling that was conveyed to me while I was there.

Q. Okay. Okay.

Now, and even through — the feeling that was conveyed to you is that even though this was not subject to the NFA or the CFTC because it was free speech materials, because they were sure it was accurate and in order to avoid attorney's fees, they let you look through everything; correct? Fair to say?

A. Wait. I'm not sure of everything you are saying in there.

Q. Okay. Let me slow down.

As you say, that was the feeling that was conveyed to you before. On this, before you looked into the other records of the various entities to check the accuracy of what was portrayed in the advertisements, the feeling that [895] was conveyed to you was that definitely the lawyers and ECP and the others felt that

that wasn't under your jurisdiction, but because they were confident it was correct and they didn't want to make a big deal out of it with attorney's fees, they would let you look through it? Fair to say, Ms. Meany? Do you remember that?

A. Fair to say.

Q. Okay. Then you looked through it.

And I want you to help me on this, because I think it is very, very important to distinguish between what you found was wrong with the ads and what you found was okay. Okay? Certain determinations you did make that they were okay.

Now, one determination you made, without trying to go back to all the exhibits — hopefully we can do this quickly — one determination you made is that the recommendations were actually sent out to all the customers on I think you said on an equal basis. It was available to all customers; right?

A. Yes, through looking at handwritten notes that Mr. Armstrong kept.

Q. Right.

A. However, and I just want to add, that we did not listen to each and every tape for each of these days.

Q. Okay. Fine.

* * *

[909] In a second I am going to go into the way you

interpreted it and how. There is another interepreation that you said this could mean the average — that the average — one contract, every time you traded one contract, you would make $11,150. That was your testimony that your interpretation could be that that is what that means in Exhibit 80 at the top; right?

A. Yes.

Q. Okay. I'm going to go into that in a second. I'm just asking you to follow through my interpretation right now; okay?

JUDGE DUNCAN: I'm sorry, Mr. Lovell. We're going to have to take another short recess.

(Brief recess.)

JUDGE DUNCAN: On the record.

BY MR. LOVELL:

Q. Okay, Ms. Meany, we left off with this last concept that we agreed to on the trades per contract as it goes up.

Now, what was the total profits over the period per each contract traded at each buy and sell recommendation as to Exhibit 80A?

A. Well, according to the recommendations, if all of the trades had actually been executed at those prices, the profit would have been $11,150.

* * *

APPENDIX I — EXCERPTS OF TRANSCRIPT OF PROCEEDINGS

[Commencing at p. 2086]

A Yes.

Q Who is Mr. Loughran?

A He was a lawyer for Princeton Economics at that time.

Q Okay.

A Actually up until I left.

Q And can you tell us when you met in '84, when during the year?

A No. I can't remember.

Q And after your first meeting with him, did you have other meetings?

A Oh, sure.

Q And did you have phone calls with him?

A All the time.

Q Did you have phone calls with him when Mr. Armstrong wasn't participating?

A Yeah. I used to talk to him quite a bit.

Q Okay.

A You know, we were trying to do this — you know, over the period, did a lot of things, disclosure documents, what to put into advertisements, what not to put into advertisements, what to put into, you know, Newsletters period.

Q Yes, compliance record keeping, things like that.

A Yes, I did that. Denise did a lot of that at that . . .

* * *

[2096] way.

Q Now, do you remember Loughran mentioning, in connection with that advice, a different statute for the words "mail fraud" or "wire fraud" instead of the CFTC disclosure?

A I can't say that I remember that.

Q You don't remember that?

A No.

Q Okay. But you remember —

A Not whether it was wire fraud or CFTC. I just remember the whole thing being done.

Q And you remember the checks being sent out, you do remember that?

A Yes. I saw the checks sent out.

Q Let me ask you, I just want to make sure of one thing.

Do you remember that Mr. Loughran had been involved in the prior disclosure documents and had, you know —

A Yes.

Q — they hadn't gone out unless he said everything was correct?

A Anything having to do with the disclosure document, I worked with Tom on.

Q And do you remember Mr. Loughran also asking questions about the relationship with Wolff and being [2097] apprised of that?

A Say it again. Repeat —

Q Do you remember Thomas Loughran, exactly in connection with the disclosure documents in the disclosure section relating to the FCMs —

A Right.

Q — of the documents, do you remember Mr. Loughran asking questions about what Armstrong's relationship with Wolff was and having the facts explained to him?

A Yeah. He knew exactly what the relationship with Wolff was.

Q And I want to ask you if it's fair to state, based on everything you observed, whether Armstrong's businesses, in making that disclosure document in that disclosure section, were relying on Loughran?

A I don't understand what you're trying to get at. But everything that was in the disclosure document was checked and advised by Tom.

Q And did he make —

A He told me how to do the calculations, how to set up the tables, and the written part.

Q All right. I think you've answered it.

Now, you knew Laurence Niren, correct? Who is Mr. Niren?

A He was a client initially, and then he became an . . .

* * *